# REQUEST TO ESTABLISH DOCKET
**(PLEASE TYPE)**

Date September 15, 1997

Docket No. 971196-TX

1. Division Name/Staff Name Communications/Pruitt
2. OPR Communications/Pruitt
3. OCR Legal & Auditing and Financial Analysis
4. Suggested Docket Title Application for certificate to provide alternative local exchange telecommunications service by Inter-Tel NetSolutions, Inc.
5. Suggested Docket Mailing List (attach separate sheet if necessary)

   A. Provide NAMES ONLY for regulated companies or ACRONYMS ONLY regulated industries, as shown in Rule 25-22.104, F.A.C.
   B. Provide COMPLETE name and address for all others. (Match representatives to clients.)

   1. Parties and their representatives (if any)

Inter-Tel NetSolutions, Inc.
John J. O'Block
120 N. 44th St., Suite 300
Phoenix, AZ 85034

   2. Interested Persons and their representatives (if any)

6. Check one:
   X Documentation is attached.
   ___ Documentation will be provided with recommendation.

I:\PSC\RAR\WP\ESTDKT.

PSC/RAR 10 (Revised 01/96)

DOCUMENT NUMBER-DATE
09335 SEP 15 ፍ
FPSC-RECORDS/REPORTING

# Bickerstaff, Heath, Smiley, Pollan, Kever & McDaniel, L.L.P.

1700 Frost Bank Plaza 816 Congress Avenue Austin, Texas 78701-2443 (512) 472-8021 Fax (512) 320-5638 http://www.bickerstaff.com

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William D. Dugat III*
[illegible]


September 5, 1997

RECEIVED
SEP 12 1997

**VIA FEDERAL EXPRESS**

Florida Public Service Commission
Division of Communications
Certification & Compliance Section
2540 Schumard Oak Blvd.
Tallahassee, FL 32399-0850
(904) 413-6600

RE: Application of Inter-Tel NetSolutions, Inc. for Authority to Provide Local Exchange Telecommunications Service Within the State of Florida

Dear Filing Clerk:

Enclosed is the original and six copies of Inter-Tel NetSolutions Inc.'s Application for Authority to Provide Local Exchange Telecommunications Service Within the State of Florida.

Also enclosed is a check made payable to the Florida Public Service Commission in the amount of $250.00 to cover the charge of the filing fee.

Please file stamp the extra copy and return to me in the enclosed self-addressed envelope.

Sincerely,

Miguel A. Huerta

Miguel A. Huerta

enclosures

Check received with filing and forwarded to Fiscal for deposit. Fiscal to forward a copy of check to RAR with proof of deposit.

Initials of person who forwarded check:

DOCUMENT NUMBER-DATE
09335 SEP 15 G
FPSC-RECORDS/REPORTING

1. This is an application for (check one):

(X) **Original authority** (new company)

( ) **Approval of transfer** (to another certificated company)
<u>Example</u>, a certificated company purchases an existing company and desires to retain the original certificate authority.

( ) **Approval of assignment of existing certificate** (to a noncertificated company)
<u>Example</u>, a non-certificated company purchases an existing company and desires to retain the certificate of authority rather than apply for a new certificate.

( ) **Approval for transfer of control** (to another certificated company)
<u>Example</u>, a company purchases 51% of a certificated company. The Commission must approve the new controlling entity.

2. Name of applicant:

Inter-Tel NetSolutions, Inc.

3. Name under which the applicant will do business (d/b/a):

Inter-Tel NetSolutions, Inc.

4. If applicable, please provide proof of fictitious name (d/b/a) registration.

Fictitious name registration number: N/A

5. A. National mailing address including street name, number, post office box, city , state, zip code, and <u>phone number</u>.

Inter-Tel NetSolutions, Inc., 120 N. 44th Street, Suite 300
Phoenix, AZ 85034 (602) 302-8989

B. Florida mailing address including street name, number, post office box, city , state, zip code, and <u>phone number</u>.
8010 Woodland Center Blvd., Ste. 1200
Tampa, FL 33614-2909 (813) 884-1010

6. Structure of organization:

( ) Individual
( ) Foreign Corporation
( ) General Partnership
( ) Joint Venture
(x) Corporation
( ) Foreign Partnership
( ) Limited Partnership
( ) Other, Please explain

7. If applicant is an individual, partnership, or joint venture, please give name, title and address of each legal entity.

Not Applicable

8. State whether any of the officers, directors, or any of the ten largest stockholders have previously been adjudged bankrupt, mentally incompetent, or found guilty of any felony or of any crime, or whether such actions may result from pending proceedings. If so, please explain.

None of the officers, directors or the sole stockholder have been adjudged bankrupt, mentally incompetent or found guilty of a crime.

9. If incorporated, please provide proof from the Florida Secretary of State that the applicant has authority to operate in Florida.

Corporate charter number: P33309

10. Please provide the name, title, address, telephone number, internet address, and facsimile number for the person serving as ongoing liaison with the Commission, and if different, the liaison responsible for this application. Ms. Lonnie J. Barrett, Corporate Paralegal, Inter-Tel, Inc., 120 N. 44th Street, Suite 200, Phoenix, AZ 85034. (602) 302-8966 (Phone); (602) 302-8929 (FAX)

11. Please list other states in which the applicant is currently providing or has applied to provide local exchange or alternative local exchange service.

Please see Attachment A

12. Has the applicant been denied certification in any other state? If so, please list the state and reason for denial.

No.

13. Have penalties been imposed against the applicant in any other state? If so, please list the state and reason for penalty. No. Inter-Tel NetSolutions has never had a complaint lodged against it since it began providing interexchange service in 1991.

14. Please indicate how a customer can file a service complaint with your company.

Please see Attachment B

15. Please complete and file a price list in accordance with Commission Rule 25-24.825.

Please see Attachment C

16. Please provide all available documentation demonstrating that the applicant has the following capabilities to provide alternative local exchange service in Florida.

A. Financial capability.

Regarding the showing of financial capability, the following applies:

The application should contain the applicant's financial statements for the most recent 3 years, including:

1. the balance sheet

2. income statement

3. statement of retained earnings.

Further, a written explanation, which can include supporting documentation, regarding the following should be provided to show financial capability.

1. Please provide documentation that the applicant has sufficient financial capability to provide the requested service in the geographic area proposed to be served.

2. Please provide documentation that the applicant has sufficient financial capability to maintain the requested service.

3. Please provide documentation that the applicant has sufficient financial capability to meet its lease or ownership obligations.

**NOTE:** This documentation may include, but is not limited to, financial statements, a projected profit and loss statement, credit references, credit bureau reports, and descriptions of business relationships with financial institutions.

If available, the financial statements should be audited financial statements.

If the applicant does not have audited financial statements, it shall be so stated. The unaudited financial statements should then be signed by the applicant's chief executive officer and chief financial officer. The signatures should attest that the financial statements are true and correct.

Please see Attachment D

**B. Managerial capability.**

Please see Attachment E

**C. Technical capability.**

(If you will be providing local intra-exchange switched telecommunications service, then state how you will provide access to 911 emergency service. If the nature of the emergency 911 service access and funding mechanism is not equivalent to that provided by the local exchange companies in the areas to be served, described in detail the difference.)

Please see Attachment E

AFFIDAVIT

By my signature below, I, the undersigned officer, attest to the accuracy of the information contained in this application and attached documents and that the applicant has the technical expertise, managerial ability, and financial capability to provide alternative local exchange service in the State of Florida. I have read the foregoing and declare that to the best of my knowledge and belief, the information is true and correct. I attest that I have the authority to sign on behalf of my company and agree to comply, now and in the future, with all applicable Commission rules and orders.

Further, I am aware that pursuant to Chapter 837.06, Florida Statutes, "Whoever knowingly makes a false statement in writing with the intent to mislead a public servant in the performance of his official duty shall be guilty of a misdemeanor of the second degree, punishable as provided in s. 775.082 and s. 775.083".

Official: John J. O'Block — Signature  9/4/97 — Date

Title: John J. O'Block  (602) 302-8900 Telephone Number

Executive Vice President

Address: Inter-Tel NetSolutions, Inc.

120 N. 44th St., Suite 300

Phoenix, AZ 85034

FORM PSC/CMU 8 (11/95)
Required by Chapter 364.337 F.S.

Attachment A

Status of providing telecommunications service in other states

Inter-Tel NetSolutions has been authorized to provide telecommunications service in the following jurisdictions indicated below.

## Interexchange Service

| Jurisdiction | | Date |
|---|---|---|
| 1. | Alabama | September 10, 1996 |
| 2. | Arizona | January 16, 1991 |
| 3. | California | May 22, 1991 |
| 4. | Colorado | January 24, 1991 |
| 5. | Florida | June 24, 1991 |
| 6. | Georgia | September 19, 1995 |
| 7. | Illinois | March 28, 1997 |
| 8. | Iowa | October 25, 1995 |
| 9. | Kansas | May 21, 1996 |
| 10. | Louisiana | April 1, 1991 |
| 11. | Maryland | April 24, 1991 |
| 12. | Michigan | January 28, 1991 |
| 13. | Missouri | June 7, 1991 |
| 14. | Minnesota | November 7, 1995 |
| 15. | Nebraska | June 25, 1996 |
| 16. | Nevada | April 11, 1995 |
| 17. | New Jersey | January 31, 1991 |
| 18. | New York | May 30, 1991 |
| 19. | New Mexico | April 10, 1995 |
| 20. | Ohio | December 17, 1992 |
| 21. | Oregon | July 23, 1996 |
| 22. | Tennessee | October 13, 1995 |
| 23. | Texas | October 30, 1990 |
| 24. | Utah | January 14, 1991 |
| 25. | Virginia | January 28, 1991 |
| 26. | Washington | May 30, 1991 |
| 27. | Wisconsin | September 10, 1991 |

## Local Exchange Service

| Jurisdiction | | Date |
|---|---|---|
| 1. | Illinois | March 28, 1997 |
| 2. | Texas | December 2, 1996 |

Customer Complaint Procedures

The Customer Service Department will be the contact for customer complaints. If customers wish to resolve the complaint in writing, they may send correspondence to:

Inter-Tel NetSolutions, Inc.
Customer Service Department
120 N. 44th Street, Suite 300
Phoenix, AZ 85034

If customers prefer to discuss the matter with a Customer Service Representative, they may call (800) 676-7601. Company Service Representatives are available to assist with customer service and billing inquiries Monday through Friday between 7:00 a.m. - 5:00 p.m. mountain time. In addition, emergency service is available twenty-four hours a day, seven days a week at the same number.

Customer complaints regarding NetSolutions' service are administered by a NetSolutions Customer Service Representative. The complaint is recorded and every attempt is made to resolve the complaint on the initial call. If not, responsibility for resolving the complaints belongs to the Customer Service Representative taking the call. Each step of the troubleshooting activity is documented and the customer is given follow-up reports, as appropriate. The average complaint is resolved within one business day.

If there is still a disagreement about a service problem, the matter will be reviewed by a Customer Service Manager. If the matter is still not resolved, NetSolutions will inform the customer of the customer's rights to contact the Florida Public Service Commission. Since NetSolutions began reselling long distance in 1991, it has never had a complaint escalate to this level.

A brief description of the qualifications of Mackey Selbig, Vice President, Customer Service may be found at Attachment E to this application.

TARIFF OF

INTER-TEL NETSOLUTIONS, INC.

APPLICABLE TO

LOCAL EXCHANGE SERVICE AND FACILITIES FOR

LOCAL EXCHANGE TELECOMMUNICATIONS SERVICES

WITHIN THE STATE OF FLORIDA



Issued by:

John J. O'Block, Executive Vice President
Inter-Tel NetSolutions, Inc.
120 North 44th Street, Ste. 300
Phoenix, Arizona 85034
602/302-8989

This tariff contains the descriptions, regulations, and rates applicable to the furnishing of local exchange service and facilities for local exchange telecommunications services provided by Inter-Tel NetSolutions, Inc., with principal offices at 120 N. 44th Street, Suite 300, Phoenix, Arizona 85034. This tariff is on file with the Florida Public Service Commission, and copies may be inspected, during normal business hours, at the Company's principal place of business.

CHECK SHEET

Sheets 1 through 30 inclusive of this tariff are effective as of the date shown at the bottom of the respective sheet(s). Original and revised sheets as named below comprise all changes from the original tariff and are currently in effect as of the date on the bottom of this page.

| SHEET | REVISION |
|---|---|
| 1 | Original* |
| 2 | Original* |
| 3 | Original* |
| 5 | Original* |
| 6 | Original* |
| 7 | Original* |
| 8 | Original* |
| 9 | Original* |
| 10 | Original* |
| 11 | Original* |
| 12 | Original* |
| 13 | Original* |
| 14 | Original* |
| 15 | Original* |
| 16 | Original* |
| 17 | Original* |
| 18 | Original* |
| 19 | Original* |
| 20 | Original* |
| 21 | Original* |
| 22 | Original* |
| 23 | Original* |
| 24 | Original* |
| 25 | Original* |

* Indicates a sheet submitted with this filing.



Issued by:

John J. O'Block, Executive Vice President
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CHECK SHEET CONT'D

| | |
|---|---|
| 26 | Original* |
| 27 | Original* |
| 28 | Original* |
| 29 | Original* |
| 30 | Original* |

* Indicates a sheet submitted with this filing.



John J. O'Block, Executive Vice President
Inter-Tel NetSolutions, Inc.
120 North 44th Street, Ste. 300
Phoenix, Arizona 85034
602/302-8989

# TABLE OF CONTENTS





Issued by:

John J. O'Block, Executive Vice President
Inter-Tel NetSolutions, Inc.
120 North 44th Street, Ste. 300
Phoenix, Arizona 85034
602/302-8989

APPLICATION OF TARIFF

This tariff contains the regulations and changes applicable to local exchange telecommunications reseller services provided by Inter-Tel NetSolutions, Inc. to customers within the State of Florida.



John J. O'Block, Executive Vice President
Inter-Tel NetSolutions, Inc.
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## TARIFF FORMAT

A. Sheet Numbering - Sheet numbers appear in the upper right corner of the page. Sheets are numbered sequentially. However, new sheets are occasionally added to the tariff. When a new sheet is added between sheets already in effect, a letter is added. For example, a new sheet added between sheets 14 and 15 would be 14A.

B. Sheet Revision Numbers - Revision numbers also appear in the upper right corner of each page. These numbers are used to determine the most current sheet version on file with the Commission. For example, the 4th revised Sheet 14 cancels the 3rd revised Sheet 14. Consult the Check Sheet for the sheet currently in effect.

C. Paragraph Numbering Sequence - There are nine levels of paragraph coding. Each level of coding is subservient to its next higher level:

2.
2.1
2.1.1.
2.1.1.(A).
2.1.1.(A).1.
2.1.1.(A).1.(a).
2.1.1.(A).1.(a).I.
2.1.1.(A).1.(a).I.(i).
2.1.1.(A).1.(a).I.(i).(1).



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TARIFF FORMAT (CONT'D)

D. Check Sheets - When a tariff filing is made with the Commission, an updated check sheet accompanies the tariff filing. The check sheet lists the sheets contained in the tariff, with a cross reference to the current revision number. When new pages are added, the check sheet is changed to reflect the revision. All revisions made in a given filing are designated by an asterisk (*). There will be no other symbols used on this page if these are the only changes made to it (i.e., the format, etc. remains the same, just revised revision levels on some pages). The tariff user should refer to the latest check sheet to find out if a particular sheet is the most current on file with the Commission.



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CONCURRING, CONNECTING OR
OTHER PARTICIPATING CARRIERS

1. Concurring Carriers - None.

2. Terminating Carriers - Inter-Tel NetSolutions, Inc., a certified local exchange provider in the State of Florida.

3. Other Participating Carriers - None.

4. Billing Agents - The local exchange company serving each particular equal access area.



Issued by:

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## SECTION 1 - SYMBOLS, TECHNICAL TERMS AND ABBREVIATIONS

### 1.1 Symbols

The following are the only symbols used for the purposes indicated below:

D - Delete or discontinue

I - Change resulting in an increase to a customer's bill

M - Moved from another price list location

N - New

R - Change resulting in a reduction to a customer's bill

T - Change in text or regulation but no change in rate or charge

SECTION 1 - SYMBOLS, TECHNICAL TERMS AND ABBREVIATIONS

1.2 Technical Terms and Abbreviations

**Commission** - The Public Service Commission of the State of Florida.

**Company** - Inter-Tel NetSolutions, Inc. ("NetSolutions" or "The Company")

**Customer or subscriber** - A person or other entity which orders service and is responsible for payment of charges due and compliance with the Company's tariff regulations.

**LATA** - Local Access Transport Area is a geographic boundary within which the LEC provides communications services. Multiple LECs may provide services within the same LATA.

**Incumbent Local Exchange Carrier (ILEC)** - The serving telephone company providing local services to subscribers on a regulated monopoly basis. This company may also provide some of the following services: LATA wide long distance, voice and data private lines, custom calling services and billing and collection services.



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## SECTION 2 - RULES AND REGULATIONS

2.1 Undertaking of Inter-Tel NetSolutions, Inc.

The Company provides local exchange telecommunications services in the State of Florida in accordance with the terms of this tariff and regulations of the Commission

Service is provided on a monthly basis and is available 24 hours per day, 7 days a week. Service will continue to be provided until terminated in accordance with the terms of this tariff.

The Company is authorized to serve as its customers' agent for purposes of ordering changes to and maintenance of the telecommunications services provided by any interexchange and/or local exchange carrier that may be necessary to implement and maintain the Company's services provided to a customer. The Company is authorized by its customers to deal directly with any such carriers and with any other vendor in all matters pertaining to its provision of service to a customer. A customer's appointment of the Company as its agent shall not apply to any software modifications that may be necessary with respect to traffic routing or least-cost routing features or functions, which modifications must be made by the customer through appropriate interaction with the responsible vendor of such features or functions. The Company's appointment as a customer's agent remains in effect unless modified or revoked in writing.

2.2 Limitations of Service

2.2.1 Service is offered subject to the availability of facilities and the provisions of this tariff. Service may be used for the transmission of communications by the Customer and the Customer's authorized user(s). The Customer may not use any of



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SECTION 2 - RULES AND REGULATIONS

2.2 Limitations of Service Cont'd

the services furnished by the Company under this tariff for any unlawful purpose.

2.2.2 The Company reserves the right to discontinue furnishing service, or limit the use of service necessitated by conditions beyond its control including, but not limited to the inability of Inter-Tel to provide comparable services under comparable terms and conditions due to unavailability of provider Services.

2.2.3 The Company reserves the right to discontinue furnishing service, or limit the use of service when the customer is using service in violation of the law or the provisions of this tariff.

2.3 Disclaimer of Warranties

The Company makes no promises, agreements, understandings, representations or warranties, express or implied, including any warranty of merchantability or fitness for a particular purpose.

2.4 Limitations of Liability

2.4.1 The liability of the Company for damages arising out of mistakes, omissions, interruptions, delays, errors or defects in transmission occurring in the course of furnishing service or other facilities and not caused by the negligence of the customer, commences upon activation of service and in no event exceeds an amount equivalent to the proportionate charge for the Company's service to the customer for the period of service during which

## SECTION 2 - RULES AND REGULATIONS

2.4 Limitations of Liability Cont'd

such mistakes, omissions, interruptions, delays, errors or defects in transmission occur for more than three (3) continuous hours.

2.4.2 The Company is not liable to the customer for direct, indirect, or consequential damages, including but not limited to, loss of use of the Company's services or lost revenues or profits.

2.4.3 The Company is not liable to the customer for any act or omission of any other company or companies furnishing a portion of the customer's service.

2.4.4 The Company is not liable for and the customer indemnifies and holds the Company harmless against any and all losses, claims, demands, suits or other actions, or any liability whatsoever whether suffered, made, instituted or asserted by the customer or by any other party or person or persons, and for any loss, damage, defacement or destruction of the premises of the customer or any other property, whether owned by the customer or others, caused or claimed to have been caused directly or indirectly by the installation, operation, failure to operate, maintenance, removal, presence, condition, location or use of equipment or wiring provided by the Company where such installation, operation, failure to operate, maintenance, removal, presence, condition, location or use is not the direct result of the negligence of the Company. No agents or employees of other carriers shall be deemed to be agents or employees of the Company.



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SECTION 2 - RULES AND REGULATIONS

2.4 Limitations of Liability Cont'd

2.4.5 The Company also is not liable for and the customer indemnifies and holds the Company harmless against:

(A) Claims for libel, slander, or infringement of copyright or unauthorized use of any trademark, trade name or service mark arising out of the material, data, information, or other content transmitted over the Company's network.

(B) Claims for patent infringement arising from combining or connecting the Company's facilities with apparatus and systems of the customer.

(C) All other claims arising out of any act or omission of the customer in connection with any service provided by the Company.

(D) Claims by Customers or third parties arising out of the unauthorized use or access of The Company Services by the Customer or unrelated third parties, including, but not limited to, misdialed numbers to any long distance number and unauthorized use of any service provided by the Company.

2.4.6 The Company shall not be liable for any interruptions or damages due to the fault or negligence of Customer or due to the failure or malfunction of Customer provided equipment or facilities. The Company shall not be liable for any interruptions or damages during any period in



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SECTION 2 - RULES AND REGULATIONS

2.4 Limitations of Liability Cont'd

which The Company is not given access to the Service premises and due to scheduled maintenance and repair. The Company shall use best efforts to obtain and keep in effect all government authorizations necessary, in order to provide Service under this Agreement. The Company shall be entitled to take and shall have no liability for any action necessary including termination to bring the Service into conformance with any governmental regulations or authorization, and Customer shall fully cooperate in and take such action as may reasonably be requested by The Company as part of such compliance. In no event shall The Company be liable for special, consequential, exemplary, or punitive damages as the result of its performance or non-performance of this Agreement.

2.4.7 The Company shall not be liable for any failure of performance or service for reasons beyond its reasonable control including, but not limited to, acts of God, fire, explosion, vandalism, cable cut, storm or other similar occurrence, any law, order, regulation, direction, action or request of the United States government or state or local governments, any instrumentality of any one or more said governments or of any civil or military authority, or by national emergencies, insurrections, riots, wars, strikes, lockouts or work stoppages or other labor difficulties, supplier failures, shortages, breaches or delays, The Company shall not be liable for any such failure of performance.



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SECTION 2 - RULES AND REGULATIONS

2.4 Limitations of Liability Cont'd

2.4.8 The Company shall use reasonable efforts to make services available by the estimated service date. The Company shall not be liable for any damages whatsoever resulting from delays in meeting the estimated service date due to delays resulting from normal installation procedures. Such delays shall include, but not be limited to delays in obtaining necessary regulatory approvals for construction, delays in obtaining right of way approvals, and delays in actual construction work being done by our vendor(s).

2.5 Customer Application for Service

Business or residential customers wishing to obtain service from the Company must execute a customer service agreement which includes the customer's authorization for the Company to instruct other carriers and vendors to provide certain services on the customer's behalf.

2.6 Establishment and Reestablishment of Credit

Applicants may be required at any time to make an advance payment up to an amount equaling one month's actual or estimated charges for the services to be provided. The Company reserves the right to examine a credit record of all applicants and customers and require a deposit of business customers which are unable to demonstrate good credit or payment histories. Deposits shall be administered as indicated in section 2.12 of this tariff.



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602/302-8989

SECTION 2 - RULES AND REGULATIONS

2.7 Notices

2.7.1 Except as provided in Section 2.14 below, any notice or demand required of customer or the Company will be effective when it is mailed, properly addressed, with postage prepaid to the other party.

2.7.2 Unless otherwise provided by these rules, any notice sent to the customer from the Company will be deemed effective when it is mailed to the customer's correct billing address.

2.7.3 Unless otherwise provided by these rules, any notice, including changes of address, from any customer or his authorized representative must be given by written notice, by mail, to the Company's business office: Inter-Tel NetSolutions, Inc., 120 N. 44th Street, Suite 300, Phoenix, Arizona 85034.

2.8 Customer Service

Company Service Representatives are available at (800) 676-7601 to assist with customer service and billing inquiries Monday through Friday between 7:00 a.m. - 5:00 p.m. M.S.T. Customer inquiries may also be addressed in writing to the Company at the address provided in Section 2.7.2 above. Twenty-four hour emergency service is also available seven days a week by dialing (800) 676-7601.

## SECTION 2 - RULES AND REGULATIONS

2.9 Rendering and Payment of Bills

2.9.1 Service is provided on a monthly (30 day) basis. Initial service for a partial month will be prorated.

2.9.2 The bill statement date is dependent on the billing cycle assigned to the customer.

2.9.3 Customers will receive bills by one of two methods:

(A) Customers may be billed directly by the Company.

(B) Customers may be billed on the Company's behalf by a third party billing service.

2.9.4 Bills are payable upon receipt and in accordance with the terms of this tariff. Bills may be paid by mail or at the Company's business office. All charges for services are payable only in United States currency, and may be made by check, money order, or cashiers check.

2.9.5 If payment of the customer's bill is not received within 30 days of the bill statement specified on the bill, the Company, at its discretion, may debit any credit card number provided by the customer for the full amount of the invoice plus any late charges that may apply.

2.9.6 The customer shall be responsible for payment of all costs of collection of past due amounts, including reasonable attorney's fees incurred by the Company.



Issued by:

John J. O'Block, Executive Vice President
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120 North 44th Street, Ste. 300
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## SECTION 2 - RULES AND REGULATIONS

### 2.9 Rendering and Payment of Bills

2.9.7 A rebilling fee, at the rate of 1.5% per month, will be charged for past due accounts unless otherwise prescribed by law, in which event the rebilling fee will be charged at the highest rate allowed by the law.

2.9.8 A charge of $20.00 will be assessed customers for any insufficiently funded check returned to the Company.

2.9.9 In the event that any change in the rates or tariffs of the carriers whose services the Company resells to its customers, the Company shall provide its customers 30 days written notice of any effect of such change in the billing rate of or service provided to the customer. Unless a customer notifies the Company in writing of its request for alteration or termination of services, any new billing rate or service change shall be deemed accepted and effective the date specified in the Company's notice.

2.9.10 Payment for installation, other non-recurring charges and the last months recurring charges will be billing on the first months invoice. All charges shall be due upon receipt of the invoice; billing shall commence upon installation. If Customer is not ready to accept The Company Services 30 days after the date Service first becomes available, The Company shall commence billing.



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SECTION 2 - RULES AND REGULATIONS

## 2.10 Disputed Bills

2.10.1 If notice of a dispute as to charges is not received, in writing, by the Company within thirty (30) days after billing statements is rendered, such billing statement shall have been deemed correct and binding upon the Customer.

2.10.2 In the case of a billing dispute between a customer and the Company for service furnished to the customer, which cannot be settled with mutual satisfaction, the customer may request, and the Company will comply with the request, an in-depth review of the disputed bill. The undisputed portion of the customer's bill, and subsequent bills, must be paid on a timely basis or the service will be subject to disconnection.

## 2.11 Discontinuance and Restoration of Service

2.11.1 Cancellation by Customer

Service will be provided for the term of service elected by the customer in the service agreement it enters into with the Company. Unless the Company receives in writing a notice of termination of services by the customer on or before thirty (30) days from the end of the agreed service period, the services provided hereunder shall continue on a monthly basis until either party shall give the other party at least thirty (30) days written notice.

The customer is responsible for payment of all charges for service furnished customer prior to the

SECTION 2 - RULES AND REGULATIONS

2.11 Discontinuance and Restoration of Service Cont'd

2.11.1 Cancellation by Customer Cont'd

actual termination of customer's service. In addition, in the event a customer terminates its service agreement with the Company prior to the end of the service period specified therein, the customer shall pay, in addition to all other charges due for service provided, a sum equal to the full balance of all monthly service charges for the remainder of the Agreement period, plus a sum equal to the value of any promotional credit awarded the customer during the term of the agreement.

2.11.2 Cancellation by the Company

In the event payment in full is not received from Customer on or before 30 days following the due date, the Company shall have the right, after giving Customer ten (10) days written notice and opportunity to cure, to suspend all or any portion of the Service to Customer until such time as Customer has (1) paid in full all charges then due, including any late fees as specified herein; (ii) provided satisfactory assurance (e.g., a deposit) of Customer's ability to pay for Service, and (iii) made advance payment of the cost of reinstating Service. If Customer fails to make all such payments by a date determined by and acceptable to the Company, Customer will be deemed to have canceled the suspended Service effective the date of such suspension.



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SECTION 2 - RULES AND REGULATIONS

2.11 Discontinuance and Restoration of Service Cont'd

2.11.1 Cancellation by Company Cont'd

The Company may discontinue service or cancel an application for service without incurring any liability under the following circumstances:

(A) For insufficient or fraudulent billing information, invalid or unauthorized telephone numbers, credit card numbers or pre-arranged account code numbers;

(B) The violation by the customer of any law, rule or regulation of any governmental authority having jurisdiction over the service;

(C) The prohibition against the Company from furnishing services by order of a court or other governmental authority having jurisdiction; or

(D) The providing of false or misleading credit information by the customer.

The Company will provide the customer written notice of such discontinuance five days prior to discontinuance.



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SECTION 2 - RULES AND REGULATIONS

2.13 Customer Responsibilities and Use Cont'd

2.13.2 Customer shall provide the necessary equipment space, conduit, and electrical power required to terminate and maintain the facilities used to provide Service on all applicable premises without charge or cost to The Company. The space, conduit, and power must be made available to The Company on a timely basis. Customer shall be responsible for assuring that the equipment space and associated facilities, conduit and rights-of-way which it is providing are a safe place to work and are protected against fire, theft, vandalism or other casually, and that the use thereof complies with all applicable laws, rules and regulations and with all applicable leases or other contractual agreements.

2.13.3 Customer shall be responsible to obtain and continue in effect all government authorizations necessary to permit Customer to receive Service and comply with its obligations under this Agreement. Customer may use the Services for any lawful purpose for which they are intended, provided that Customer will not use the Services so as to interfere with or impair Service over any of the facilities and associated equipment of The Company or authorized vendors of The Company, or to impair the privacy of any communications over the fiber optic facilities and associated equipment.

2.13.4 Customer agrees that all rights, title and interest in all the fiber optic or other facilities and equipment provided by The Company, or any authorized vendors of The Company, hereunder shall at all times remain exclusively with the Company.



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## SECTION 2 - RULES AND REGULATIONS

### 2.13 Customer Responsibilities and Use Cont'd

2.13.5 Customer shall not create or permit to be created any liens or encumbrances relating to Customer's use of the Service or arising from the location of the equipment. Upon termination of Service, The Company shall remove its equipment and shall have the right, but not the obligation, to remove all other facilities from any applicable premises. The Company shall use reasonable efforts to maintain the Services in accordance with applicable performance standards therefore. There are no additional charges for The Company maintenance services. However, The Company shall have no responsibility for the maintenance and repair of the facilities and equipment which it does not furnish and The Company may access Customer its standard charge for false call outs.

### 2.14 Company Responsibilities

In the event of the Company's foreknowledge of an interruption of service for a period exceeding 24 hours, the Company will use its best efforts to notify the customer in advance by telephone or in writing.

### 2.15 Deposits

The Company does not require deposits from its residential customers. A deposit may be required of any business customer who is unable to demonstrate a good credit or payment history. Any deposits collected will be administered in compliance with Commission Rules.



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SECTION 2 - RULES AND REGULATIONS

2.16 Taxes

All applicable federal, state and local use, rules, excise or privilege taxes, duties or similar liabilities, chargeable to or against Customer due to Service provided to Customer (i.e., gross receipts tax, sales tax, municipal utilities tax) shall be charged to the Customer as separate line items and are not included in the quoted rates and are payable by the Customer.



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## SECTION 3 - DESCRIPTION OF PRODUCTS AND SERVICES

### 3.0 Product Availability

These products and rates are currently available only in the cities of Miami and Fort Lauderdale. Additional cities will be included as service becomes available. Additional products and/or features may become available and will be priced on a case by case basis.

### 3.1 Private Lines

3.1.1 DSO - DSO private line with bandwidths ranging from 2.4 kbps to 65 kbps.

3.1.2 DS1 - A DS1 private line is equivalent to twenty-four (24) 64 kbps circuits, totaling 1.544 mbps. These circuits can be used to connect multiple offices within the same metropolitan area, or can be used to connect to a long distance carrier of the customers choice. A DS1 provides a direct connection to a long distance carrier and provides for lower long distance rates although a monthly charge will be charged for the local DS1 circuit from the customer to the long distance carrier.

3.1.3 DS3- A DS3 private line is equivalent to twenty-eight (28) DS1's, totaling approximately 43 mbps. These circuits can also be used to connect multiple offices within the same metropolitan area, or can be used to connect to a long distance carrier of the customers choice. These circuits will be used in high bandwidth applications. Applications may include the transferring of large computer files between a software companies multiple locations or hospitals transferring MRI's (medical recognition images) to other facilities.



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3.1.4 OC3 - An OC3 private line contains 155.52 mbps of bandwidth and are usually used in applications that involve carriers or Internet providers. OC3 circuits are used as an actual part of a carriers network backbone.

3.1.5 OC12 - An OC12 private line contains 622.08 mbps of bandwidth and are usually used in applications that involve carriers or Internet providers. OC12 circuits are used as an actual part of a carriers network backbone.

3.2 Switched Products

3.2.1 DS1 - A local DS1 with dial tone simply provides 24 channels for local calling.

3.2.2 PRI - An integrated services digital network configuration of 23 B channels, each operating at 64 kbps, and a single D channel, operating at 64 kbps, in a 23B+D configuration.

3.2.3 BRI - An integrated services digital network configuration of 2B channels, each operating at 64 kbps, and a single D channel, operating at 16 kbps, in a 2B+D configuration.

3.3 Data Products

3.3.1 LAN Circuits - These data circuits can run at ethernet (10 mbps or 100 mbps speed) or token ring (4 mbps or 16mbps speed) protocal.

3.3.2 ATM - (asychronous transfer mode) is a high-speed, high volume, packet-switching transmission protocol that uses short, uniform, 53-byte cells to divide data into efficient, manageable packets for ultrafast switching through a high-performance



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network. The 53-byte cells contain 5-byte destination address headers and 48 data bytes.

## SECTION 4 - RATES

### 4.1 Private Lines

DSO — Not currently available, tariff modifications will be provided when product is available.

DS1 — (type I circuits only)

| | |
|---|---|
| Channel Termination | $149.00/location |
| Fixed Mileage | $96.00 |
| Variable Mileage | $24.00/mile |
| Installation Charge | $930.00 |

DS3 — (type I circuits only)

| | |
|---|---|
| Channel Termination | $2430.00/location |
| Fixed Mileage | $1591.00 |
| Variable Mileage | $213/mile |
| Installation Charge | $1215.00 |

OC3 — Pricing is done on a case-by-case basis and no standard pricing is available.

OC12 — Pricing is done on a case-by-case basis and no standard pricing is available.

### 4.2 Switched Services

DS1

| | |
|---|---|
| DOD Monthly | $1000.00 |
| DOD Install | $1000.00 |
| Combo (two-way) Monthly | $1000.00 |
| Combo (two-way) Install | $1000.00 |
| DID/DOD Monthly | $1240.00 |
| DID/DOD Install | $1090.00 |
| DID Monthly | $1480.00 |
| DID Install | $1090.00 |



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SECTION 4 - RATES

4.2 Switched Services Cont'd

PRI

| | |
|---|---|
| Combo (DOD and DID) Monthly | $1495.00 |
| Combo (DOD and DID) Install | $1100.00 |

BRI

Not currently available, tariff modifications will be provided when product is available.

Individual Business Lines

Not currently available, tariff modifications will be provided when product is available.

Extended Area Service $ 0.070 per minute

4.3 Data Products

LAN Circuits

Pricing is done on a case-by-case basis and no standard pricing is available.

ATM

Pricing is done on a case-by-case basis and no standard pricing is available.



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Attachment D

Financial Capability of Inter-Tel NetSolutions, Inc.

Materials have been incorporated by reference into this Report from the following documents: (1) materials from the registrant's Proxy Statement relating to its 1997 Annual Meeting of Shareholders have been incorporated by reference into Part III and Part IV and (2) documents from the registrant's Form S-1 Registration Statements (Nos. 2-70437 and 33-70054), Form S-3 Registration Statements (Nos. 33-58161, 33-61437, 333-01735 and 333-12433), Form S-8 Registration Statements (Nos. 2-94805, 33-40353 and 33-73620), Annual Reports on Form 10-K for the years December 31, 1984, 1988 and 1994, and current reports on Form 8-K dated July 17, 1987, August 3, 1988 have been incorporated by reference into Part IV, Item 14. Portions of the Annual Report to Shareholders for the year ended December 31, 1996 are incorporated by reference into Part II.

## INTER-TEL, INCORPORATED
## 1996 FORM 10-K ANNUAL REPORT

### TABLE OF CONTENTS

**UNITED STATES**
**SECURITIES AND EXCHANGE COMMISSION**
**Washington, D.C. 20549**

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**FORM 10-K**
**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)**
**OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the fiscal year ended December 31, 1996**

**Commission File Number: 0-10211**

**INTER-TEL, INCORPORATED**

**Incorporated in the State of Arizona** **I.R.S. No. 86-0220994**

**120 North 44th Street, Suite 200**
**Phoenix, Arizona 85034-1822**

**(602) 302-8900**

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Securities registered pursuant to Section 12(g) of the Act:

Common Stock
(12,951,163 shares outstanding as of March 14, 1997)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (S 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K - [ ].

The aggregate market value of the voting stock held by non-affiliates of the registrant, based upon the last reported sales price in NASDAQ National Market System on March 14, 1997, was approximately $149,000,000 Shares of Common Stock held by each executive officer and director have been excluded in that such persons may be deemed to be affiliates.

Materials have been incorporated by reference into this Report from the following documents: (1) materials from the registrant's Proxy Statement relating to its 1997 Annual Meeting of Shareholders have been incorporated by reference into Part III and Part IV and (2) documents from the registrant's Form S-1 Registration Statements (Nos. 2-70437 and 33-70054), Form S-3 Registration Statements (Nos. 33-58161, 33-61437, 333-01735 and 333-12433), Form S-8 Registration Statements (Nos. 2-94805, 33-40353 and 33-73620), Annual Reports on Form 10-K for the years December 31, 1984, 1988 and 1994, and current reports on Form 8-K dated July 17, 1987, August 3, 1988 have been incorporated by reference into Part IV, Item 14. Portions of the Annual Report to Shareholders for the year ended December 31, 1996 are incorporated by reference into Part II.

**INTER-TEL, INCORPORATED**
**1996 FORM 10-K ANNUAL REPORT**

## TABLE OF CONTENTS

## PART I

### ITEM 1. BUSINESS

#### The Company

*This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Readers are cautioned that such statements are only predictions and involve risks and uncertainties. Actual results could differ materially from those projected in the forward-looking statements as a result of the risk factors set forth under "Factors That May Affect Results Of Future Operations" below and elsewhere in this report.*

Inter-Tel, incorporated in Arizona in 196[illegible], is a single point of contact, full service solutions integrator providing *AXXESS* and Axxent digital business communication platforms, *AXXESSORY Talk* voice processing platforms, call processing and voice processing software along with various other productivity enhancing software applications, computer telephone integration, and network services and long distance calling services, as well as maintenance, leasing and support services. The Company's Common Stock is quoted on the Nasdaq National Market System under the symbol INTL.

The Company has developed a distribution network of direct sales offices, dealers and value added resellers (VARs) which sell the Company's products to small-to-medium-size organizations and to divisions or departments of larger organizations, including Fortune 500 companies, large service organizations and governmental agencies. The Company has 29 direct sales offices in the United States, one in the United Kingdom, one in Japan and a network of hundreds of dealers and VARs who purchase directly from the Company. The Company is also in the process of expanding its international dealer network.

The Company's strategy is to offer to its customers, through a broad distribution network, the total solution for their communications needs—a single source for their full range of telephony requirements, and to provide to its market segment, on a cost-effective basis, advanced technologies that have achieved acceptance in the market for larger systems.

#### Products and Services

The Company's current and planned products and services span the following portions of its market segment:

- Digital Communication Platforms
- Computer Telephone Integration
- Voice Processing Software
- Internet Connectivity
- Networking Technologies
- Network and Long Distance Services
- Flexible Financing

The market for the Company's products and services is characterized by rapid technological change and continuing demand for new products, features and applications. See "Factors That May Affect Results of Future Operations -- Rapid Technological Change and Dependence on New and Timely Product Introductions."

other applications on the PC or workstation. Applications include database look-up (which utilizes Caller-ID information to retrieve customer information automatically from a computerized database), automated attendant, interactive voice response, automatic call distribution (which queues and prioritizes incoming calls), and call accounting (which permits the monitoring of telephone usage and toll cost). The *AXXESS* system is managed through a Microsoft Windows-based graphical user interface on a PC to facilitate installation, system configuration and programming.

The *AXXESS* system utilizes advanced software to configure and utilize real-time digital signal processing ("DSP") semiconductor components incorporated into the system hardware. The use of DSPs and related software lowers system costs, permits higher functionality and increases system flexibility. For example, DSPs can be configured by the system manager for different combinations of speakerphones, conference capabilities and other DSP-based facilities. The system's speakerphones incorporate full-duplex technology, which permits speakerphones to transmit in both directions at the same time without the necessity to override one speaker's voice to prevent feedback interference.

The *AXXESS* software is written in a high-level, object-oriented language which can operate on many commonly used processors. Accordingly, the software can be readily ported to other hardware platforms. The Company intends to port the *AXXESS* software to faster microprocessors which will permit the *AXXESS* to grow to a much larger size, in order to enhance the functionality and performance of these larger systems and to permit a migration path from the smaller *AXXESS* system as a customer's system requirements increase.

**Inter-Tel Axxent**

The Company introduced its newest product line, the Inter-Tel Axxent, in the third quarter of 1995. The system originally supported 16 lines and 8 trunks. Software version 2.0, released in third quarter 1996, increased the system capacity to 24 lines and 12 trunks. Small businesses are demanding advanced telephony applications formerly reserved only for large corporations. The Inter-Tel Axxent is designed to bring many of the advanced features and functionality of the *AXXESS* system to smaller installations on a cost-effective basis while enabling users to migrate to an *AXXESS* system as their telecommunications needs evolve. The Inter-Tel Axxent provides capabilities such as computer telephone integration, DSP technology, real-time ACD reporting, and integrated voice processing. Housed in a compact PC type mid-tower, the Inter-Tel Axxent platform also offers the convenience of a default database so the system is fully operational as soon as it is plugged in. Basic database programming can also be performed through the digital telephone terminals. The system is sold through direct sales offices and direct dealers to professional businesses such as doctors, lawyers, and architects.

In addition to its line of digital communication platforms, the Company continues to have success in its direct sales offices and dealer distribution channels with its traditional IMX and G-Series family of products. These products economically bring advanced communication services to the Company's customers, however, without the advantages of the open architecture capabilities of the *AXXESS* and Inter-Tel Axxent. These products include:

- GLX and GLX+
- GMX-48
- IMX 1224/2448/2460
- IMX/GMX 256
- IMX/GMX 416/832

Inter-Tel also distributes other leading telecommunications products from its Factored Products Division through its direct sales offices, dealers and VARs. Factored Products represents products that Inter-Tel has endorsed as the leading communications peripherals utilized in many day-to-day functions. Businesses require telecommunications products to provide increased productivity, ease of operations and reliability. Many of these products interface with Inter-Tel telephone systems. Inter-Tel's product selection consists of videoconferencing, battery backup, headsets, surge protection, paging equipment, wireless communications and data multiplexers.

**Computer Telephone Integration (CTI)**

Through Computer Telephone Integration (CTI), two of the most important business tools—the computer and the telephone—are linked into one environment to provide streamlined business processes and enhanced customer service.

With CTI technology and Inter-Tel's industry-standard communication platforms and C++, object oriented, call processing software, users can be better prepared to answer incoming telephone calls. With Inter-Tel's *AXXESSORY Connect* software for the *AXXESS* system and local Caller I.D. information, users can accept phone calls through their desktop PC. Caller information can appear on the screen even before the call is answered. On an individual desktop or a company-wide network basis, Inter-Tel offers a variety of products, such as *AXXESSORY ACD*, that can manage automatic call distribution at peak efficiency or route incoming telephone calls, based on various parameters, to a specific person. It can also collect, analyze and report real-time call processing information for staff forecasting and analysis.

Certain of Inter-Tel's software applications can also integrate with other "off-the-shelf" Windows applications such as personal information managers, call routing or call management software that can further enhance customer service while increasing call efficiency and employee productivity. Inter-Tel has partnered with a number of third party software developers to integrate with their existing applications to create a working environment for database, personal organizer, or terminal emulation programs.

If these "off-the-shelf" applications do not completely meet the needs of a customer, the open design of Inter-Tel's software allows independent software developers to write custom applications through Inter-Tel's Developer's Program. Or, Inter-Tel's CTI Solutions Group can provide professional consulting services or development of individual customer applications, for either desktop or Local Area Network ("LAN")-based applications.

Call management applications that were once reserved for large call centers, such as airline reservation centers or banking operations, are now available and affordable from Inter-Tel for most businesses. The Company intends to design future enhancements to integrate LAN-based solutions on a Windows NT Server.

**Voice Processing Software**

Inter-Tel's *AXXESSORY Talk*, Axxent Talk, and the IVX500 are all voice processing platforms that work with Inter-Tel's communication platforms. All three applications use the Multi-Vendor Interface Protocol (MVIP), an industry standard for connecting multi-vendor PC-based boards in voice processing, data switching and video systems.

Future enhancements to *AXXESSORY Talk*, the voice processing software for the *AXXESS* platform are planned, including the ability to program and schedule multiple voice mail greetings, cancel unheard messages, detect and route incoming faxes to a specific extension and the ability to automatically return a call from voice mail by using Caller I.D.

As the need to merge different types of messages continues to evolve, Inter-Tel is developing unified messaging software, scheduled for release in the third quarter of 1997. By using standard electronic mail gateway technology, Inter-Tel's unified messaging software will be designed to enable the integration of all types of messages into a single user interface on a PC, supporting internet e-mail and major electronic mail packages including Microsoft Mail, Microsoft Exchange, Lotus Notes and cc:Mail. Integrating e-mail, fax and voice mail through one message management interface at both the PC and the phone could allow users to easily see and control all different types of messages that have been received.

Inter-Tel is developing unified messaging software to work in conjunction with the Microsoft Exchange messaging application, included with Windows 95 as well as Microsoft's new Outlook product. Inter-Tel's unified messaging software will conform to the Messaging Application Programming Interface (MAPI) standard developed by Microsoft and will work with the *AXXESSORY Talk* digital voice processing platform.

Inter-Tel's unified messaging software should provide yet another means for improving workplace productivity and retrieving messages anywhere from a phone or a PC connected to a modem.

**Internet Connectivity**

With the advent of Internet telephony, more companies are relying on the Internet for the delivery of streamlined marketing, sales and customer support, as well as affordable alternatives to fax, express mail and other forms of global communications. In 1996, Inter-Tel developed the Vocal'Net Server.

The Vocal'Net Server, scheduled for commercial release in the summer of 1997, is a stand-alone Internet telephony solution available for use with the *AXXESS* system or virtually any business telephone system equipped with T-1 capability. It provides a gateway for bridging the public telephone network and a company's intranet or the Internet. With the Vocal'Net Server, users will be able to conduct real-time, full-duplex, high-quality, two-way voice communications over the Internet, for potential savings compared to standard long distance phone service. Designed to meet the needs of most businesses, the Vocal'Net Server will be available in multiple port sizes.

The Vocal'Net Server does not require customized telephone sets or specialized software and cards in each desktop computer. Furthermore, the Vocal'Net Server does not rely on the central processing unit of the computer for the compression or packetization of information. Therefore, the server may be able to handle additional functions as well.

Because Internet telephony converts all transmissions to the same type of packets, both voice and data can use the same data circuits, thereby reducing backlog on the data circuits and increasing efficiency. Bandwidth is maximized to a point that some users may be able to reduce the overall number of circuits needed.

The Vocal'Net Server is designed to allow businesses to create virtual offices, enabling traveling or off-site employees to connect to the main office from anywhere in the country or the world. All that is needed is a laptop computer and the number of a local Internet Service Provider to receive multimedia messages and to place calls over the Internet. Another application is "Touch-To-Talk" telephony-enabled web pages, which allows users to automatically connect over the Internet to talk to customer service agents.

In its initial commercial release scheduled for mid-1997, the Vocal'Net Server will be designed to work with business telephone systems that support E&M signaling over T-1 lines and to handle up to 24 simultaneous calls, offering advanced Internet telephony technology. Future planned enhancements will include industry standard compatibility (H.323) for integration with PC-based software applications and other types of gateways as well as a fax gateway to provide fax and broadcast fax capabilities across the Internet.

**Networking Technologies**

To develop a solid foundation for state-of-the-art data and telecommunications networking, customers require strategic network expertise from their networking provider. Designing, installing and supporting the complete integration of a customer's complex data and telecommunications network, from land-based LANs to geographically dispersed Wide Area Networks (WANs), is a key goal of Inter-Tel.

By forming alliances with major manufacturers of hardware and software technologies, Inter-Tel is working to provide the routers, ATM, LAN and WAN switches, file servers, intelligent hubs and any other device required for the customer's intranet or for usage of the Internet. Pre-sale design support, project coordination for implementation, and installation support are offered on the full line of Inter-Tel server-based telephony products and services.

**Network and Long Distance Services**

The enactment of the Telecommunications Act of 1996 greatly impacted both the telecommunications industry and NetSolutions, Inter-Tel's network and long-distance services provider, by opening telecommunications markets to local and private carriers.

Working with domestic and international carriers, Inter-Tel NetSolutions offers a wide range of voice, data and video services. Using state-of-the-art technology, such as digital fiber optics, NetSolutions offers services that include domestic and international long distance, dedicated services such as frame relay and private line circuits, and pre-paid and traditional calling cards.

Call centers using T-1 access for incoming toll-free traffic, sales offices using NetSolutions' switched long distance or companies linking multiple offices throughout the country on a frame relay network are examples of the applications currently supported by Inter-Tel NetSolutions. Whether it is toll-free service or WAN design, Inter-Tel NetSolutions is capable of handling a broad spectrum of telecommunications needs.

Inter-Tel NetSolutions intends to offer local service, Internet access and wireless products, thus continuing Inter-Tel's evolution as a total solution provider. However, these services are not currently provided, and there can be no assurance that the Company will be able to provide these services in the future.

**Flexible Financing**

An integral part of bringing the total solution to the customer is to provide a range of affordable financing programs in one flexible and convenient package. With Inter-Tel, customers can acquire their telephony and computer platforms, software applications and network services, as well as financing, all from a single source.

Inter-Tel's Totalease program provides qualified customers with that total solution for their telephony products. The Totalease program includes full system maintenance and training, fixed equipment add-on and upgrade provisions, risk of loss, guaranteed renewal options and other services, all at a fixed monthly cost. With Totalease, Inter-Tel manages the responsibilities and risks associated with ownership of communications equipment.

Inter-Tel also offers a line of low cost lease purchase financing. Lease terms range from 24 to 84 months with $1.00, fixed and fair market value purchase options. In addition, Inter-Tel will customize financing packages to suit customers with special financial needs. By offering this type of financing to acquire Inter-Tel products and services, Inter-Tel provides the customer with the comfort of predictable monthly costs and the security of a direct, long term relationship with Inter-Tel.

**Sales and Distribution**

The Company has developed a broad distribution network of direct sales offices, dealers and value added resellers (VARs) which market the Company's products to small to medium size organizations and divisions or departments of larger organizations. In the United States, the Company has 29 direct sales offices and a network of hundreds of dealers who purchase systems directly from the Company. Direct dealers are typically located in geographic areas in which the Company does not maintain direct sales offices. The Company is additionally pursuing distribution of its products through value added resellers (VARs). These resellers have traditionally sold complex data solutions to customers, and the Company is seeking to leverage this distribution network to capitalize on the merging of the computer and telephony industries. The Company maintains a dealer support office and direct sales office in the United Kingdom and has a network of approximately 20 dealers in the United Kingdom and Europe. In addition, in 1993 the Company opened a dealer support office and direct sales office in Japan and is in the process of establishing dealers in Asia.

The Company believes that its success depends in part upon the strength of its distribution channels and the ability of the Company to maintain close access to its end user customers. In recent periods, the Company has sought to improve its access to end user customers by effecting strategic acquisitions of resellers of telephony products and services in markets in which the Company has existing direct sales offices and in other strategic markets. To this end, in 1996 the Company acquired Florida Telephone Systems, Inc. and NTL Corporation (dba ComNet of Ohio). The Company has expanded its direct sales office personnel from a total of 332 persons at December 31, 1992 to a total of 795 at December 31, 1996.

The Company's sales through its direct sales offices as a percentage of total sales have decreased from 62.1% of net sales in 1993 to 56.4% of net sales in 1996. Sales to distributors, dealers, and VARs have increased from 29.6% of net sales in 1993 to 31.5% of net sales in 1996. Sales through the Company's long distance and network services operation have increased from 0.7% of net sales in 1993 to 6.5% of net sales in 1996.

Sales of systems through the Company's direct dealers typically generate lower gross margins than sales through the Company's direct sales organization, although direct sales typically require higher levels of sales, marketing, general and administrative expenses. Accordingly, the Company's margins may vary from period to period depending upon the mix of dealer and direct sales. Direct dealers and VARs typically enter into non-exclusive reseller contracts for a term of one or more years. The Company generally provides support and other services to the reseller pursuant to the terms of the agreement. The agreements often include requirements that the reseller meet or use its best efforts to meet minimum annual purchase quotas. The Company's experience is that dealers and VARs maintain low inventories of the Company's products and, accordingly, the Company has experienced insignificant stock rotation returns and price protection credits to date.

International sales, which to date have been made through the Company's United Kingdom and Japan subsidiaries, accounted for approximately 1.5%, of net sales in 1996. In order to sell its products to customers in other countries, the Company must comply with local telecommunications standards. The Company's AXXESS system can be readily altered through software modifications, which the Company believes will facilitate compliance with these local regulations. The Company had previously experienced delay in the United Kingdom in achieving final regulatory approval of its products; however, approvals were received during 1996 to market and sell the Company's digital product lines. In addition, the AXXESS system has been designed to support multi-lingual functionality, and currently supports English and Japanese. The Company is presently establishing dealer networks in Japan and Asia and is working to expand its dealer network in the United Kingdom and Europe.

**Research and Development**

The Company's research and development efforts over the last several years have been focused primarily on developing new products like the Inter-Tel Axxent system, enhancing the CTI capabilities of the *AXXESS* product, as well as expanding the capacity of the Company's *AXXESS* and *AXXESSORY Talk* systems. Current efforts are related to support of industry standard CTI interfaces, development of additional applications and features, the development of an Internet voice server (Vocal'Net server), and the development of a LAN-based Communications Server incorporating the Company's Call Processing and Voice Processing software. New applications under development also include Basic Rate ISDN, telecommunications networking, and unified messaging software. The software-based architecture of the *AXXESS* system facilitates maintenance and support, upgrades, and incorporation of additional features and functionality.

The Company had a total of 95 personnel engaged in research and development as of December 31, 1996. Research and development expenses were $6,581,711, $5,763,517 and $4,536,882 for 1996, 1995 and 1994, respectively.

**Manufacturing**

The Company manufactures substantially all of its systems through third party subcontractors located in the United States, China and the Philippines. These subcontractors use both standard and proprietary integrated circuits and other electronic devices and components to produce telephone switches, telephones and printed circuit boards to the Company's engineering specifications and designs. The suppliers also inspect and test the equipment before delivering them to the Company, which in some cases then performs systems integration, software loading, final testing and shipment. The Company maintains written agreements with its principal suppliers. The Company provides a forecast schedule to its suppliers and revises the forecast on a periodic basis.

Foreign manufacturing facilities are subject to changes in governmental policies, imposition of tariffs and import restrictions, and other factors beyond the Company's control. Certain of the microprocessors, integrated circuits and voice processing interface cards used in the Company's systems are currently available from a single or limited sources of supply. From time to time, the Company experiences delays in the supply of components and finished goods. Delay or lack of supply from existing sources or the inability to develop alternative sources if and when required in the future could materially and adversely affect operating results.

**Customer Service and Support**

The Company believes that customer service and support is a critical component of customer satisfaction and the success of the Company's business. The Company operates a Technical Support "hotline" to provide a range of telephone support to its distributors, dealers and end user customers through a toll-free number. The Company also provides on-site customer support and, through remote diagnostic procedures, has the ability to detect and correct system problems from its Technical Support facilities.

Information taken from customer call records allows feedback into Inter-Tel's Quality First continuous improvement process, thus providing a road map for continuous product and service enhancements. Each direct sales office is given a periodic service activity report summarizing the reasons that technicians are asking for assistance and common issues that give rise to technical inquiries. This allows them to analyze trends in their service operations and provide better customer service.

**Quality**

The Company believes that the quality of its systems, customer service and support, and other aspects of its organization is a critical element of meeting the needs of its customers. Through its Quality First continuous improvement process initiated in 1991, Inter-Tel implements quality processes throughout its business operations. The Company has established formal procedures to ensure responsiveness to customer requests, to monitor response times and to measure customer satisfaction. The Company has also established means by which all end users, including customers of the Company's resellers, can make product enhancement requests directly to the Company. The Company supports its dealers and VARs through an extensive training program at the Company's facility and at dealer sites, a toll-free telephone number for sales and technical support, and the provision of end user marketing materials. The Company typically provides a one year warranty on its systems to end users. In manufacturing, the Company continuously monitors the quality of the products produced on its behalf by the Company's manufacturing subcontractors, and is extending the Company's Quality First continuous improvement process to its suppliers.

**Competition**

The market for the Company's products is highly competitive and in recent periods has been characterized by pricing pressures and business consolidations. The Company's competitors include Lucent Technologies (formerly AT&T) and NorTel (formerly Northern Telecom), as well as Comdial, Executone, Iwatsu, Mitel, NEC, Nitsuko, Panasonic, ROLM, Toshiba and others. Many of these competitors have significantly greater financial, marketing and technical resources than the Company. The Company also competes against the regional Bell operating companies (RBOCs), which offer systems produced by one or more of the aforementioned competitors and also offer Centrex systems in which automatic calling facilities are provided through equipment located in the telephone company's central office.

The Telecommunication Act of 1996 and AT&T's announcement to divide itself into three enterprises has had an impact on competition in the communication industry. The

Telecommunication Act of 1996 opened the market for telephone and cable television services, forcing telephone companies to open their networks to competitors and giving consumers a choice of local phone carriers. Conversely, local phone companies are now able to offer long distance services. In addition, cable companies can offer telephone services and Internet access. These changes will increase competition in the communication industry and will create additional competition and opportunities in customer premise equipment as these new services and interfaces become available.

In the market for voice processing applications, including voice mail, the Company competes against Centigram Communications Corporation, Octel Corporation, AVT and other competitors, certain of which have significantly greater resources than the Company. In the market for long distance services, the Company competes against AT&T, MCI, US Sprint and other competitors, many of which have significantly greater resources than the Company. With the recent Telecommunications Act, the Company will also compete with RBOCs and cable companies for long distance business. Key competitive factors in the sale of telephone systems and related applications include performance, features, reliability, service and support, name recognition, distribution capability and price. The Company believes that it competes favorably in its markets with respect to the performance, features and price of its systems, as well as the level of service and support that the Company provides to its customers. Certain of the Company's competitors have significantly greater name recognition and distribution capabilities than the Company, although the Company believes that it has developed a competitive distribution presence in certain markets, particularly those where the Company has direct sales offices. The Company expects that competition will continue to be intense in the markets addressed by the Company, and there can be no assurance that the Company will be able to continue to compete successfully.

As the Company enters the markets for local telephone service and Internet access, it will face additional competition from RBOCs and other providers, which have larger marketing and sales organizations, significantly greater financial and technical resources and a larger and more established customer base than the Company. In Addition, RBOCs and other providers have greater name recognition, more established positions in the market and long standing relationships with customers. Therefore, there can be no assurance that the Company will compete successfully in these markets.

To the extent that Inter-Tel develops more server-based telecommunications products, Inter-Tel's competition will be the large computer software companies, such as IBM (Lotus), and Microsoft. In addition, the server-based telephony market has shown increasing competition from small software start-up companies.

**Intellectual Property Rights**

In addition to the factors discussed above, the Company's ability to compete successfully depends on its ability to protect the proprietary technology contained in its products. The Company relies principally upon a combination of copyright and trade secret laws and contractual provisions to establish and protect its proprietary rights in its systems. The Company generally enters into confidentiality agreements with its employees and suppliers, and limits access to its proprietary information. There can be no assurance that these protections will be adequate to deter misappropriation of the Company's technologies or independent third party development of similar technologies or product features.

From time to time, the Company is subject to assertions that the Company's products infringe the intellectual property rights of third parties. Such claims could require the Company to expend significant sums in litigation, could require the Company to pay damages, and could require the Company to develop non-infringing technology or to acquire licenses to the technology which is the subject of the claimed infringement.

**Employees**

As of December 31, 1996, the Company had a total of 1,193 employees, of whom 972 were engaged in sales, marketing and customer support, 58 in quality, manufacturing and related operations, 95 in research and development, and 68 in finance and administration. The Company's future success will depend upon its ability to attract, retain and motivate highly qualified employees, who are in great demand. The Company believes that its employee relations are excellent.

**Factors That May Affect Results of Future Operations**

In evaluating the Company's business, prospective investors should carefully consider the following factors in addition to the other information presented in this Form 10-K.

*Rapid Technological Change and Dependence on New and Timely Product Introductions*

The market for the Company's software, products and services is characterized by rapid technological change and continuing demand for new products, features and applications. Current competitors or new market entrants may develop new products or product features that could adversely affect the competitive position of the Company's products. Accordingly, the timely introduction of new products and product features, as well as new telecommunications applications, will be a key factor in the Company's future success. Occasionally, new products contain undetected errors or "bugs" when released. Such bugs may result from defects contained in software products offered by the Company's suppliers or other third parties that are intended to be compatible with the Company's products, over which the Company has little or no control. Although the Company seeks to minimize the number of bugs in its products by its test procedures and strict quality control, there can be no assurance that its new products will be error free when introduced. Any significant delay in the commercial introduction of the Company's products due to bugs, any design modifications required to correct bugs or any impairment of customer satisfaction as a result of bugs could have a material adverse effect on the Company's business and operating results. In addition, new products often take several months before their manufacturing costs stabilize, which may adversely affect operating results for a period of time following introduction. During the past twelve months, the Company introduced ISDN on its *AXXESS* digital communication platform, expanded the size of the *AXXESS* and Inter-Tel Axxent platforms, introduced a number of upgrades to its existing *AXXESSORY Talk* and IVX-500 voice processing platforms and announced the introduction of the Vocal'Net Server product. In the event that the Company were to fail to successfully introduce new software, products or services or upgrades to its existing systems or products on a regular and timely basis, demand for the Company's existing software, products and services could decline, which could have a material adverse effect on the Company's business and operating results. Additionally, there can be no guaranty that future costs of accessibility, lack of capacity or voice transmission quality of the Internet will not adversely affect the ability of the Company to deliver all Internet products and services on a cost effective basis. There can be no assurance that the Company will be able to successfully develop new software, products, services, technologies and applications on a timely basis as required by changing market needs or that new software or products or enhancements thereto, including its recently announced products and upgrades, when introduced by the Company, will achieve market acceptance.

services. In addition, cable companies can offer telephone services and Internet access. These changes will increase competition in the communication industry and will create additional competition and opportunities in customer premise equipment as these new services and interfaces become available. As the Company enters the markets for local telephone service and Internet access, it will face additional competition from RBOCs and other providers, which have larger marketing and sales organizations, significantly greater financial and technical resources and a larger and more established customer base than the Company. In Addition, RBOCs and other providers have greater name recognition, more established positions in the market and long standing relationships with customers. Therefore, there can be no assurance that the Company will compete successfully in these markets.

In the market for voice processing applications, including voice mail, the Company competes against Centigram Communications Corporation ("Centigram"), Octel Communications Corporation ("Octel"), Active Voice Corporation ("Active Voice"), Applied Voice Technology, Inc. ("AVT") and other competitors, including telephone systems manufacturers such as Lucent Technologies, NorTel and ROLM, which offer integrated voice processing systems under their own label as well as through various OEM arrangements. Certain of the Company's competitors may achieve marketing advantages by bundling their voice processing equipment with sales of telephone systems, or by designing their telephone systems so that they do not readily integrate with independent voice processing systems. Inter-Tel expects that the development of industry standards and the acceptance of open systems architectures in the voice processing market will reduce technical barriers to market entry and lead to increased competition.

In the market for long distance services, the Company competes against AT&T Corp., MCI Telecommunications Corporation, Sprint Corporation and other suppliers, certain of which also supply the long distance calling and network services that the Company resells. Although the Company acquires a variety of long distance calling services in bulk from certain long distance carriers, there can be no assurance that the Company will be able to purchase long distance calling services on favorable terms from one or more of such providers in the future. In addition, a substantial majority of prospective new long distance customers for the Company currently purchase long distance calling services from the Company's competitors. The Company believes that it is likely to face increased competition in the long distance calling services market as a result of telecommunications deregulation, which enables RBOCs to supply long distance calling and network services, and enables RBOCs and others to bundle long distance, local telephone and wireless services. Moreover, the Company expects to face increased competition in the future because low technical barriers to entry will allow new market entrants.

As Inter-Tel develops more server-based and CTI telecommunications products, Inter-Tel's competition will be the large computer software companies, such as IBM (Lotus), and Microsoft. In addition, the server-based telephony and CTI markets have shown increasing competition from small software start-up companies.

Many of the Company's competitors are substantially larger, and have significantly greater financial and technical resources, name recognition and marketing and distribution capabilities, than the Company. The Company expects that competition will continue to be intense in the markets addressed by its products and services, and there can be no assurance that the Company will be able to compete successfully in the future.

*Management of Growth; Implementation of New Management Information Systems*

The growth in the Company's business has placed, and is expected to continue to place, a significant strain on the Company's personnel, management and other resources. The

Company's ability to manage any future growth effectively will require it to attract, train, motivate and manage new employees successfully, to integrate new employees into its overall operations and to continue to improve its operational, financial and management information systems.

The Company implemented a new MIS system late in 1995. The MIS system significantly affected many aspects of the Company's business, including its accounting, operations, purchasing, sales and marketing functions. Since the date of implementation, the Company has experienced difficulty with the new MIS system software, which increased the Company's costs, had an adverse effect on the Company's ability to provide products and services to its customers on a timely basis and caused delays in coordinating accounting and financial results. During the fourth quarter of 1996, the Company determined that the limitations of the existing system software would prevent Inter-Tel from establishing an integrated and centralized dispatch and telemarketing center.

During the fourth quarter of 1996, the Company decided to replace its MIS system software with an integrated solution from a more established vendor and accordingly has written off the software license and implementation costs relating to the system software being replaced. Inter-Tel has signed an agreement with a large, established software and database vendor to implement, maintain and support alternate MIS system software to be utilized throughout the Company. Inter-Tel believes that such action was necessary to allow for the stability and growth of Inter-Tel.

The actions to replace the MIS system software could result in additional costs and probable delays in obtaining a fully functional MIS system, including but not limited to additional or alternate hardware and software required, but not available in the current system configuration, and additional personnel, which could have a material adverse effect on the company's business and operating results. In addition, implementation of this system software and the transition from the current system software to the new information system software will require substantial financial resources and personnel.

The Company has made strategic acquisitions in the past and expects to continue to do so in the future. Acquisitions require a significant amount of the Company's management attention and financial and operational resources, all of which are limited. The integration of acquired entities may also result in unexpected costs and disruptions, and significant fluctuations in, or reduced predictability of, operating results from period to period. There can be no assurance that an acquisition will not adversely affect the business relationships of the Company or the acquired entity with their respective suppliers or customers. Further, there can be no assurance that the Company will successfully integrate the acquired operations or achieve any of the intended benefits of an acquisition. The Company's failure to manage its growth effectively could have a material adverse effect on its business and operating results.

*Product Protection and Infringement*

The Company's future success is dependent in part upon its proprietary technology. The Company has no patents and relies principally on copyright and trade secret law and contractual provisions to protect its intellectual property. There can be no assurance that any copyright owned by the Company will not be invalidated, circumvented or challenged or that the rights granted thereunder will provide competitive advantages to the Company. Further, there can be no assurance that others will not develop technologies that are similar or superior to the Company's technology or that duplicate the Company's technology.

As the Company expands its international operations, effective intellectual property protection may be unavailable or limited in certain foreign countries. There can be no assurance that the steps taken by the Company will prevent misappropriation of its technology. Litigation may be necessary in the future to enforce the Company's intellectual property rights, to protect the Company's trade secrets, to determine the validity and scope of the proprietary rights of others, or to defend against claims of infringement or invalidity. Such litigation or delays in product introductions or decisions to discontinue development, manufacture or sale of such products, could result in substantial costs and diversion of resources and could have a material adverse effect on the Company's business and operating results.

*Reliance on Dealer Network*

A substantial portion of the Company's net sales are made through its network of independent dealers. The company faces intense competition from other telephone system and voice processing system manufacturers for such dealers' business, as most of the Company's dealers carry products which compete with the Company's products. The Company has no exclusive agreements with any of its dealers. The loss of any significant dealer or group of dealers, or any event or condition adversely affecting the Company's dealer network, could have a material adverse effect on the Company's business and operating results.

*Risks of Providing Long Distance and Network Services*

Inter-Tel depends on a reliable supply of telecommunications services and information from several long distance carriers. Because it does not own transmission facilities, the Company relies on long distance carriers for the provision of network services to the Company's customers and for billing information. Long distance services are subject to extensive and uncertain governmental regulation on both the federal and state level. There can be no assurance that the promulgation of certain regulations will not adversely affect the Company's business and operating results. Contracts with the long distance carriers from which the Company currently resells services typically have a multi-year term in which the Company's prices are relatively fixed and have minimum use requirements. There can be no assurance that the Company will meet minimum use commitments, will be able to negotiate lower rates with carriers in the event of any decrease in end user rates or will be able to extend its contracts with long distance carriers at prices favorable to the Company. The Company's ability to continue to expand its long distance service operations will depend on its ability to continue to secure reliable long distance services from a number of long distance carriers and the willingness of such carriers to continue to make telecommunications services and billing information available to the Company on favorable terms.

*Dependence on Key Personnel*

The Company is dependent on the continued service of, and its ability to attract and retain, qualified technical, marketing, sales and managerial personnel. The competition for such personnel is intense, and the loss of any of such persons, as well as the failure to recruit additional key technical and sales personnel in a timely manner, would have a material adverse effect on the Company's business and operating results. There can be no assurance that the Company will be able to continue to attract and retain the qualified personnel necessary for the development of its business.

*Possible Volatility of Stock Price*

The Company believes that factors such as announcements of developments relating to the Company's business, fluctuations in the Company's operating results, general conditions in the telecommunications industry or the worldwide economy, changes in legislation or regulation affecting the telecommunications industry, an outbreak of hostilities, a shortfall in revenue or earnings from securities analysts' expectations, announcements of technological innovations or new products or enhancements by the Company or its competitors, developments in intellectual property rights and developments in the Company's relationships with its customers and suppliers could cause the price of the Company's Common Stock to fluctuate, perhaps substantially. Many of such factors are beyond the Company's control. In addition, in recent years the stock market in general, and the market for shares of technology stocks in particular, have experienced extreme price fluctuations, which have often been unrelated to the operating performance of affected companies. There can be no assurance that the market price of the Company's Common Stock will not experience significant fluctuations in the future, including fluctuations that are unrelated to the Company's performance.

*Concentration of Ownership*

As of December 31, 1996, the Company's Chairman of the Board of Directors and Chief Executive Officer beneficially owned approximately 21% of the outstanding shares of the Common Stock. As a result, he has the ability to exercise significant influence over all matters requiring shareholder approval. In addition, the concentration of ownership could have the effect of delaying or preventing a change in control of the Company.

## DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

| Name | Age | Position |
|---|---|---|
| Steven G. Mihaylo | 53 | Chairman of the Board of Directors and Chief Executive Officer |
| Thomas C. Parise | 42 | President and Chief Operating Officer |
| Craig W. Rauchle | 41 | Executive Vice President |
| Ross McAlpine | 45 | President of Inter-Tel Leasing, Inc. |
| Kurt R. Kneip | 34 | Vice President, Chief Financial Officer, Secretary and Assistant Treasurer |
| J. Robert Anderson | 60 | Director |
| Gary Edens | 55 | Director |
| Maurice H. Esperseth | 71 | Director |
| C. Roland Haden | 56 | Director |
| Norman Stout | 39 | Director |

**MR. MIHAYLO**, the founder of the Company, has served as Chairman of the Board of Directors of the Company since September 198[illegible], as President from March 1984 until December 1994, and as Chief Executive Officer of the Company since its formation in July 1969. Mr. Mihaylo also served as President of the Company from July 1969 until September 1983 and as Chairman of the Board of Directors from July 1969 to October 1982. Mr. Mihaylo also is a director of MicroAge, Inc. and Microtest, Inc.

**MR. PARISE** was elected President of the Company in December 1994. He has been Senior Vice President of the Company since 1986. He is also President of Inter-Tel Integrated Services, Inc., a wholly owned research and development, manufacturing and distribution subsidiary of the Company. Mr. Parise joined the Company in 1981 and became Branch General Manager of the Phoenix Direct Sales Office in 1982. In 1983, he became the Mountain Regional Vice President, and in January 1985 he was appointed Vice President of Operations and Sales Support. Mr. Parise also is a director of Globe Business Resources, Inc.

**MR. RAUCHLE** was elected Executive Vice President in December 1994. He had been Senior Vice President of the Company and continues as President of Inter-Tel DataCom, Inc., a wholly owned sales subsidiary of the Company. In addition, he currently serves the Company and all subsidiaries in corporate strategic planning and mergers and acquisitions activities. Mr. Rauchle joined the Comp. y in 1979 as Branch General Manager of the Denver Direct Sales Office and in 1983 was appointed the Central Region Vice President and subsequently the Western Regional Vice President. From 1990 to 1992, Mr. Rauchle served as President of Inter-Tel Communications, Inc.

**MR. MCALPINE** has served as Pre ident of Inter-Tel Leasing, Inc., a wholly-owned subsidiary of the Company, since April 93. He also served as Vice President of Inter-Tel Communications, Inc. from April 1991 to April 1992 and Treasurer since April 1992. He joined the Company in July 1991 when Inter-Tel acquired Telecommunications Specialists, Inc. Prior to joining Inter-Tel, Mr. McAlpine worked 17 years in the leasing and financial services industry. Mr McAlpine holds an undergraduate degree in Accounting from Southwest Texas State University.

**MR. KNEIP** has served as Vice President and Chief Financial Officer of the Company since September 1993. He was elected Secretary and Treasurer in October 1994. In May 1996 he was elected Assistant Treasurer, as John Abbott was elected Treasurer. He joined the Company in May 1992 as Director of Corporate Tax, after seven years with the accounting firm of Ernst & Young. Mr. Kneip is a Certified Public Accountant, and holds an undergraduate degree in Commercial Economics from South Dakota State University and a Masters Degree in Professional Accountancy from the University of South Dakota.

**MR. ANDERSON** was elected as a director of the Company in February 1997. Mr. Anderson worked for Ford Motor Company from 1963 to 1983, serving from 1978 to 1983 as President of the Ford Motor Land Development Corporation. He served as Senior Vice President, CFO and a member of the Board of Directors of The Firestone Tire and Rubber Company from 1983 to 1989, and as Vice Chairman of Bridgestone/Firestone, Inc. from 1989 through 1991. He most recently served as Vice Chairman, CFO and a member of the Board of Directors of the Grumman Corporation from 1991 to 1994. Mr. Anderson is currently semi-retired, and he is an active leader in various business, civic and philanthropic organizations.

**MR. EDENS** was elected as a director of the Company in October 1994. He has been a broadcasting media executive from 1970 to 1994, serving as Chairman and Chief Executive Officer of Edens Broadcasting, Inc. from 1984 to 1994 when that corporation's nine radio stations were sold. He presently is President of The Hanover Companies, Inc., an investment firm. He is an active leader in various business, civic and philanthropic organizations.

**MR. ESPERSETH** has been a director of the Company since October 1986. Mr. Esperseth joined the Company in January 1983 as Senior Vice President-Research and Development, after a 32-year career with GTE, and served as Executive Vice President of Inter-Tel from 1986 to 1988. Mr. Esperseth retired as an officer of the Company on December 31, 1989.

**DR. HADEN** has been a director of the Company since 1983. Dr. Haden has been Vice Chancellor and Dean of Engineering of Texas A&M University since 1993. Previously, he served as Vice Chancellor of Louisiana State University from 1991 to 1993, Dean of the College of Engineering and Applied Sciences at Arizona State University from 1989 to 1991, Vice President for Academic Affairs at Arizona State University from 1987 to 1988, and Dean of the College of Engineering and Applied Sciences from 1978 to 1987. Dr. Haden holds a doctoral degree in Electrical Engineering from the University of Texas and has served on the faculties of the University of Oklahoma and Texas A & M University.

**MR. STOUT** was elected a director of the Company in October 1994. Mr. Stout has been President of Superlite Block, a manufacturer of concrete block since February 1993. Prior thereto he was employed by Bouhem-Fields, Inc. of Dallas, Texas, a manufacturer of crushed stone, as Chief Executive Officer from 1990 to 1993 and as Chief Financial Officer from 1986 to 1990. Previously, Mr. Stout was a Certified Public Accountant with Coopers & Lybrand.

The Board of Directors has an Audit Committee and a Compensation Committee. The Audit Committee, consisting of Directors Anderson, Stout and Esperseth, is charged with reviewing the Company's annual audit and meets with the Company's independent auditors to review the Company's internal controls and financial management practices. The Compensation Committee, consisting of Messrs. Esperseth, Edens and Stout, recommends to the Board of Directors compensation for the Company's key employees and administers the Company's stock option plans.

## ITEM 2. PROPERTIES

The Company maintains its corporate headquarters at 120 North 44th Street, Suite 200, Phoenix, Arizona pursuant to a lease that expires in 2000. It also maintains its distribution and support operations in an 85,000 square foot building located in Chandler, Arizona pursuant to a lease that expires in 2008. In addition, the Company leases sales and support offices in a total of 29 direct sales offices in the United States and two locations overseas. The Company's aggregate monthly payments under these leases are currently $239,092. The Company believes that its existing facilities are adequate to meet its current needs and that additional or alternative space will be available as necessary in the future on commercially reasonable terms.

## ITEM 3. LEGAL PROCEEDINGS

The Company has no legal proceedings in process or pending for which it believes an unfavorable outcome would have a material adverse impact on the financial position of the Company.

## ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

## PART II

## ITEM 5. MARKET FOR THE REGISTRANT'S COMMON STOCK AND RELATED STOCKHOLDER MATTERS

The information required by this Item is incorporated by reference to Exhibit 13.0 and Page 38 of the Company's 1996 Annual Report to Shareholders.

**ITEM 6. SELECTED FINANCIAL DATA**

The information required by this Item is incorporated by reference to Exhibit 13.0 and Page 18 of the Company's 1996 Annual Report to Shareholders.

**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The information required by this Item is incorporated by reference to Exhibit 13.0 and Pages 30 through 37 of the Company's 1996 Annual Report to Shareholders.

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

The information required by this Item is incorporated by reference to Exhibit 13.0 and Pages 19 through 29 of the Company's 1996 Annual Report to Shareholders.

**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

Not applicable.

## PART III

Certain information required by Part III is omitted from this report in that the Registrant will file a definitive proxy statement pursuant to Regulation 14A (the "Proxy Statement") not later than 120 days after the end of the fiscal year covered by this Report, and the information included therein is incorporated herein by reference

**ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT**

Information with respect to directors and executive officers is included at the end of Part I, Item 1 on Pages 18 to 20 of this report under the caption "Directors and Executive Officers of the Registrant."

**ITEM 11. EXECUTIVE COMPENSATION**

The information required by this Item is incorporated by reference to Pages 8 to 11 of the Company's Proxy Statement relating to its 1997 Annual Meeting of Shareholders.

**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT**

The information required by this Item is incorporated by reference to Pages 5 and 6 of the Company's Proxy Statement.

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

Not applicable.

## PART IV

## ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(a) The following documents are filed as part of this Report:

### 1. Financial Statements

The following consolidated financial statements of Inter-Tel, Incorporated, and subsidiaries, are incorporated by reference to Exhibit 13.0 and Pages 19 to 29 of the Company's Annual Report:

Report of Ernst & Young LLP, Independent Auditors

Consolidated balance sheets--December 31, 1996 and 1995

Consolidated statements of income--years ended December 31, 1996, 1995 and 1994

Consolidated statements of shareholders' equity--years ended December 31, 1996, 1995 and 1994

Consolidated statements of cash flows--years ended December 31, 1996, 1995 and 1994

Notes to consolidated financial statements

### 2. Financial Statement Schedules

The following consolidated financial statement schedule of Inter-Tel, Incorporated, and subsidiaries is filed as part of this Report and should be read in conjunction with the Consolidated Financial Statements of Inter-Tel, Incorporated and subsidiaries, and the notes thereto.

Schedule for the three years ended December 31, 1996:

| | Page No. |
|---|---|
| Schedule II--Valuation and Qualifying Accounts | 27 |

Schedules not listed above have been omitted because they are not applicable or are not required or the information required to be set forth therein is included in the Consolidated Financial Statements or notes thereto.

### 3. Exhibits

| | |
|---|---|
| 3.1(10) | Articles of Incorporation, as amended. |
| 3.2(16) | By-Laws, as amended. |
| 10.15(1) | Registrant's form of standard Distributor Agreement. |

| | |
|---|---|
| 10.16(1) | Registrant's form of standard Service Agreement. |
| 10.34(2) | 1984 Incentive Stock Option Plan and forms of Stock Option Agreement. |
| 10.35(3) | Agreement between Registrant and Samsung Semiconductor and Telecommunications Company, Ltd. dated October 17, 1984. |
| 10.37(3) | Tax Deferred Savings Plan. |
| 10.51(11) | 1990 Directors' Stock Option Plan and form of Stock Option Agreement. |
| 10.52(15) | Inter-Tel, Incorporated Long-Term Incentive Plan and forms of Stock Option Agreements. |
| 10.53(12) | Agreement between Registrant and Maxon Systems, Inc. dated February 27, 1993. |
| 10.54(12) | Agreement between Registrant and Varian Tempe Electronics Center dated February 26, 1991. |
| 10.55(12) | Agreement between Registrant and Jetcrown Industrial Ltd. dated February 18, 1993. |
| 10.56(13) | Employee Stock Ownership Plan. |
| 10.57(14) | Loan and Security Agreement dated December 16, 1994 between Bank One, Arizona, N.A. and Registrant. |
| 10.58 (16) | Development, Supply and License Agreement between Registrant and QUALCOMM dated January 17, 1996. |

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(1) Previously filed with Registrant's Registration Statement on Form S-1 (File No. 2-70437).

(2) Previously filed with Registrant's Registration Statement on Form S-8 (File No. 2-94805).

(3) Previously filed with Registrant's Annual Report on Form 10-K for the year ended November 30, 1984 (File No. 0-10211).

(10) Previously filed with Registrant's Annual Report on Form 10-K for the year ended December 31, 1988 (File No. 0-10211).

(11) Previously filed with Registrant's Registration Statement on Form S-8 (File No. 33-40353).

(12) Previously filed with Registrant's Registration Statement on Form S-1 (File No. 33-70054).

(13) Previously filed with Registrant's Registration Statement on Form S-8 (File No. 33-73620).

(14) Previously filed with Registrant's Annual Report on Form 10-K for the year ended December 31, 1994 (File No. 0-10211).

(15) Previously filed with Registrant's Proxy Statement dated March 23, 1994.

(16) Previously filed with Registrant's Annual Report on Form 10-K for the year ended December 31, 1995 (File No. 0-10211).

(17) Filed herewith, except as noted.

(b) Reports on Form 8-K.

None.

(c) Exhibits.

11.1 Statement re: Computation of Per Share Earnings. (Page 28)

13.0 Excerpts from Annual Report to Security Holders. (not attached herewith; a copy of the excerpts of the Company's Annual Report to Security Holders was filed with the Securities and Exchange Commission and a complete copy of the Annual Report is available upon request by writing to Shareholder Relations, Inter-Tel, Incorporated, 120 N. 44th Street, Suite 200, Phoenix, Arizona 85034)

23.0 Consent of Independent Auditors. (Page 29)

24.1 Power of Attorney. (Page 26)

See Item 14(a) (3) also.

(d) Financial Statement Schedules

The response to this portion of Item 14 is submitted as a separate section of this report. See Item 8.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant, Inter-Tel, Incorporated, has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

INTER-TEL, INCORPORATED

BY: /S. Steven G. Mihaylo
Steven G. Mihaylo
Chairman and Chief Executive Officer

Dated: March 21, 1997

## EXHIBIT 24.1--POWER OF ATTORNEY

**KNOW ALL MEN BY THESE PRESENTS**, that each person whose signature appears below constitutes and appoints Steven G. Mihaylo and Kurt R. Kneip, jointly and severally, his attorneys-in-fact, each with the power of substitution, for him in any and all capacities, to sign any amendments to this Report on Form 10-K, and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact, or his substitute or substitutes, may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the Registrant in the capacities and on the dates indicated.

| Signature | Title | Date |
|---|---|---|
| /S/ Steven G. Mihaylo<br>Steven G. Mihaylo | Chairman and Chief Executive Officer | March 21, 1997 |
| /S/ Kurt R. Kneip<br>Kurt R. Kneip | Vice President and Chief Financial Officer | March 21, 1997 |
| /S/ J. Robert Anderson<br>J. Robert Anderson | Director | March 21, 1997 |
| /S/ Gary D. Edens<br>Gary D. Edens | Director | March 21, 1997 |
| /S/ Maurice H. Esperseth<br>Maurice H. Esperseth | Director | March 21,1997 |
| /S/ C. Roland Haden<br>C. Roland Haden | Director | March 21, 1997 |
| /S/ Norman Stout<br>Norman Stout | Director | March 21, 1997 |

## SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS

(in thousands)

| COL. A | COL. B | COL. C | | COL. D | COL. E |
|---|---|---|---|---|---|
| | | ADDITIONS | | | |
| DESCRIPTION | Balance at Beginning of Period | Charged to Costs & Expenses | Charged to Other Accounts Describe | Charged to Deductions Describe | Balance at End of Period |
| **Year ended December 31, 1996** | | | | | |
| Deducted from asset accounts: | | | | | |
| Allowance for doubtful accounts (4) | $1,822 | $1,801 | $87(3) | $614(1) | $3,096 |
| Allowance for lease accounts | $1,513 | $1,945 | $(87)(3) | $665(1) | $2,706 |
| Inventory allowance (4) | $2,499 | $609 | $175(5) | $304(2) | $2,979 |
| **Year ended December 31, 1995** | | | | | |
| Deducted from asset accounts: | | | | | |
| Allowance for doubtful accounts (4) | $1,181 | $814 | $71 (3) | $244(1) | $1,822 |
| Allowance for lease accounts | $1,198 | $780 | $(71)(3) | $394(1) | $1,513 |
| Inventory allowance (4) | $1,795 | $1,109 | -- | $405(2) | $2,499 |
| **Year ended December 31, 1994** | | | | | |
| Deducted from asset accounts: | | | | | |
| Allowance for doubtful accounts (4) | $708 | $721 | $(105)(3) | $143(1) | $1,181 |
| Allowance for lease accounts | $911 | $236 | $105 (3) | $54(1) | $1,198 |
| Inventory allowance (4) | $1,237 | $561 | -- | $3(2) | $1,795 |

(1) Uncollectible accounts written off, net of recoveries.
(2) Inventory written off.
(3) Reclassed between appropriate valuation and qualifying accounts.
(4) Adjusted for pooling of Florida Telephone Systems, Inc.
(5) Acquired in purchase of NTL Corporation (dba ComNet of Ohio).

**EXHIBIT 11.1**
**STATEMENT RE: COMPUTATION OF PER SHARE EARNINGS**

| (In thousands, except per share amounts) | | Years Ended December 31, 1996 | 1995 | 1994 |
|---|---|---|---|---|
| **PRIMARY** | | | | |
| Average shares outstanding | | 12,890 | 11,528 | 10,671 |
| Net effect of dilutive stock options-- based on the treasury stock method using average market price | | 505 | 473 | 229 |
| | **TOTAL** | 13,395 | 12,001 | 10,900 |
| Net income | | $9,042 | $8,499 | $5,940 |
| Net income per share | | $.68 | $.71 | $ .54 |
| **FULLY DILUTED** | | | | |
| Average shares outstanding | | 12,890 | 11,528 | 10,671 |
| Net effect of dilutive stock options-- based on the treasury stock method using the year-end market price, if higher than the average market price | | 507 | 496 | 229 |
| | **TOTAL** | 13,397 | 12,024 | 10,900 |
| Net income | | $9,042 | $8,499 | $5,940 |
| Net income per share | | $.68 | $.71 | $ .54 |

The Computation of Per Share Earnings for all periods has been restated to reflect the acquisition of Florida Telephone Systems, Inc. in May 1996, accounted for as a pooling of interests, in which 48,193 shares of common stock were issued.

## EXHIBIT 23.0--CONSENT OF ERNST & YOUNG LLP, INDEPENDENT AUDITORS

We consent to the incorporation by reference on page 21 in this Annual Report (Form 10-K) of our report dated February 28, 1997 included in the 1996 Annual Report to Shareholders of Inter-Tel, Incorporated.

Our audit also included the financial statement schedule of Inter-Tel, Incorporated listed in Item 14(a). This schedule is the responsibility of the Company's management. Our responsibility is to express an opinion based upon our audits. In our opinion, the financial statement schedule referred to above, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We also consent to the incorporation by reference in Registration Statement (Form S-3 No. 33-58161), Registration Statement (Form S-3 No. 33-61437), Registration Statement (Form S-3 No. 333-01735), ), Registration Statement (Form S-3 No. 333-12433), Registration Statement (Form S-8 No. 2-94805), Registration Statement (Form S-8 No. 33-40353), and in Registration Statement (Form S-8 No. 33-73620) of our report dated February 28, 1997, with respect to the consolidated financial statements incorporated herein by reference and our report included in the preceding paragraph with respect to the financial statement schedule included in this Annual Report (Form 10-K) of Inter-Tel, Incorporated.

Phoenix, Arizona
March 21, 1997

/S/ ERNST & YOUNG LLP

## INDEX

## INTER-TEL, INCORPORATED AND SUBSIDIARIES

**UNITED STATES**
**SECURITIES AND EXCHANGE COMMISSION**
**Washington, D.C. 20549**

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**FORM 10-Q**
**QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarter ended
March 31, 1997

Commission File Number:
0-10211

**INTER-TEL, INCORPORATED**

Incorporated in the State of Arizona

I.R.S. No. 86-0220994

**120 North 44th Street, Suite 200**
**Phoenix, Arizona 85034-1822**

**(602) 302-8900**

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Common Stock

(12,958,463 shares outstanding as of March 31, 1997)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter periods that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes _x_ No ___

## INDEX

### INTER-TEL, INCORPORATED AND SUBSIDIARIES

## PART I. FINANCIAL INFORMATION

## INTER-TEL, INCORPORATED AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)

| (In thousands) | March 31, 1997 | December 31, 1996 |
|---|---|---|
| **ASSETS** | | |
| **CURRENT ASSETS** | | |
| Cash and equivalents | $41,843 | $38,936 |
| Accounts receivable - net | 29,568 | 29,998 |
| Inventories | 21,060 | 21,280 |
| Net investment in sales-leases | 10,546 | 8,243 |
| Prepaid expenses and other assets | 6,270 | 7,008 |
| TOTAL CURRENT ASSETS | 109,287 | 105,465 |
| **PROPERTY & EQUIPMENT** | 11,953 | 11,189 |
| **OTHER ASSETS** | 13,907 | 15,957 |
| | $135,147 | $132,611 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | |
| **CURRENT LIABILITIES** | | |
| Accounts payable | $ 7,922 | $ 8,915 |
| Other current liabilities | 16,864 | 16,841 |
| TOTAL CURRENT LIABILITIES | 24,786 | 25,756 |
| **DEFERRED TAXES AND OTHER LIABILITIES** | 12,805 | 11,921 |
| **SHAREHOLDERS' EQUITY** | | |
| Common stock | 59,948 | 59,875 |
| Retained earnings | 38,134 | 35,464 |
| Equity adjustment for foreign currency translation | (503) | (359) |
| | 97,579 | 94,980 |
| Less receivable from Employee Stock Ownership Trust | (23) | (46) |
| TOTAL SHAREHOLDERS' EQUITY | 97,556 | 94,934 |
| | $135,147 | $132,611 |

## INTER-TEL, INCORPORATED AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME (Unaudited)

| (In thousands, except per share amounts) | Three Months Ended March 31, 1997 | Three Months Ended March 31, 1996 |
|---|---|---|
| **NET SALES** | $50,322 | $42,213 |
| Cost of sales | 28,152 | 22,901 |
| **GROSS PROFIT** | 22,170 | 19,312 |
| Research & development | 1,845 | 1,704 |
| Selling, general, and administrative | 16,052 | 13,200 |
| | 17,897 | 14,904 |
| **OPERATING INCOME** | 4,273 | 4,408 |
| Interest and other income | 223 | 446 |
| Interest expense | (7) | (4) |
| **INCOME BEFORE TAXES** | 4,489 | 4,850 |
| Income taxes | 1,819 | 1,951 |
| **NET INCOME** | $2,670 | $2,899 |
| **NET INCOME PER SHARE** | $.20 | $.22 |
| Average number of shares outstanding | 13,346 | 13,293 |

## INTER-TEL, INCORPORATED AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

| (In thousands) | Three Months Ended March 31, 1997 | March 31, 1996 |
|---|---|---|
| **OPERATING ACTIVITIES** | | |
| **NET INCOME** | $ 2,670 | $2,899 |
| Adjustments to reflect operating activities: | | |
| Depreciation and amortization | 1,069 | 921 |
| Changes in operating assets and liabilities | (166) | (7,230) |
| Other | 1,795 | 2,130 |
| **NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES** | 5,368 | (1,280) |
| **INVESTING ACTIVITIES** | | |
| Additions to property and equipment | (1,709) | (1,597) |
| Cash used in acquisition | (825) | 0 |
| **NET CASH USED IN INVESTING ACTIVITIES** | (2,534) | (1,597) |
| **FINANCING ACTIVITIES** | | |
| Proceeds from exercise of stock options | 73 | 89 |
| **NET CASH PROVIDED BY FINANCING ACTIVITIES** | 73 | 89 |
| **INCREASE/(DECREASE) IN CASH AND EQUIVALENTS** | 2,907 | (2,788) |
| **CASH AND EQUIVALENTS AT BEGINNING OF PERIOD** | 38,936 | 39,640 |
| **CASH AND EQUIVALENTS AT END OF PERIOD** | $41,843 | $36,852 |

INTER-TEL, INCORPORATED AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

March 31, 1997

## NOTE A--BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of the results for the interim periods presented have been included. Operating results for the three months ending March 31, 1997 are not necessarily indicative of the results that may be expected for the year ended December 31, 1997. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's annual report on Form 10-K for the year ended December 31, 1996.

## NOTE B--INCOME PER SHARE

Primary earnings per share assume that outstanding common shares were increased by shares issuable upon the exercise of all outstanding stock options to which market price exceeds exercise price less shares which could have been purchased with related proceeds.

In February 1997, the Financial Accounting Standards Board issued Statement No. 128, *Earnings per Share*, which is required to be adopted on December 31, 1997. At that time, the Company will be required to change the method currently used to compute earnings per share and to restate all prior periods. Under the new requirements for calculating primary earnings per share, the dilutive effect of stock options will be excluded. The impact is expected to result in an increase in primary earnings per share for the first quarter ended March 31, 1997 and March 31, 1996 of $.01 and $.01 per share, respectively. The impact of Statement 128 on the calculation of fully diluted earnings per share for these quarters is not expected to be material.

## PART I.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### Overview

Inter-Tel is a single point of contact, full service solutions integrator providing *AXXESS* and Axxent digital business communication platforms, Axxessory Talk voice processing platforms, call processing and voice processing software along with various other productivity enhancing software applications, computer telephone integration, and network services and long distance calling services, as well as maintenance, leasing and support services. The Company's Common Stock is quoted on the Nasdaq National Market System under the symbol INTL.

This Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Actual results could differ materially from those projected in the forward-looking statements as a result of many risk factors, including, without limitation, those set forth under "Factors That May Affect Future Results Of Operations" below.

### Results of Operations

Net sales increased 19.2% to $50.3 million in the first quarter of 1997 from $42.2 million in the first quarter of 1996. Sales from direct sales offices accounted for approximately $6.2 million of the increase, while wholesale distribution sales decreased approximately $500,000. The remaining increases occurred in long distance sales and other operations.

The following table sets forth selected statements of income data as a percentage of net sales:

| | Three months and year Ended March 31, 1997 | 1996 |
|---|---|---|
| Net sales | 100.0% | 100.0% |
| Cost of sales | 55.9 | 54.3 |
| Gross profit | 44.1 | 45.7 |
| Research and development | 3.7 | 4.0 |
| Selling, general and administrative | 31.9 | 31.3 |
| Operating income | 8.5 | 10.4 |
| Interest and other income | 0.4 | 1.1 |
| Interest expense | 0.0 | 0.0 |
| Income taxes | 3.6 | 4.6 |
| Net income | 5.3% | 6.9% |

Gross profit for the first quarter of 1997 increased 14.8% to $22.2 million, or 44.1% of net sales, from $19.3 million, or 45.7% of net sales, in the first quarter of 1996. Gross margin decreased slightly compared to the first quarter of 1996, but was higher than the year ended December 31, 1996 gross margin. The different sales mix of products and services, and sales through different distribution channels each impact the Company's gross margin. The Company received higher margins from sales of AXXESS digital communication platforms, call processing software and voice processing software, which were offset by lower margins on sales through dealer channels and sales of long distance calling services.

Research and development expenses for the first quarter of 1997 increased 8.3% to $1.8 million, or 3.7% of net sales, from $1.7 million, or 4.0% of net sales, for the first quarter of 1996. This increase was primarily attributable to expenses relating to the continued development of the *AXXESS* and Inter-Tel Ax..:nt s:ftware and systems, unified messaging and voice processing software, Inter-Tel.Net and Vocal'Net server, and CTI applications. The Company expects that research and development expenses will continue to increase in absolute dollars as the Company continues to develop and enhance existing and .ew technologies and products. These expenses may vary, however, as a percentage of net sales.

Selling, general and administrative expenses in the first quarter of 1997 increased to $16.1 million, or 31.9% of net sales, from $13.2 million, or 31.3% of net sales, in the first quarter of 1996. This reflected increased selling, incentive, training and other compensation costs attributable to the increased sales through the Company's direct sales offices, additional personnel to support the direct dealer network and expanded long distance operations, and expenses associated with the expansion of international operations. In addition, the Company increased its sales and technical training staff, expanded its credit management group and made appropriate increases in reserves for accounts receivable. The Company expects that selling, general and administrative expenses will increase in absolute dollars, but may vary as a percentage of net sales.

Other income in both periods consisted primarily of interest income and foreign exchange rate gains and losses and decreased in the first quarter of 1997 primarily due to differences in net foreign exchange rate gains and losses.

Net income for the first quarter of 1997 was $2.7 million ($.20 per share), compared to net income of $2.9 million ($.22 per share) for the first quarter of 1996, a decrease of 7.9%.

### Inflation/Currency Fluctuation

Inflation and currency fluctuations have not previously had a material impact on Inter-Tel's operations. International procurement agreements have traditionally been denominated in U.S. currency. Moreover, a significant amount of contract manufacturing has been moved to domestic sources. The expansion of international operations in the United Kingdom and Europe and anticipated increased sales in Japan and Asia and elsewhere could result in higher international sales as a percentage of total revenues, but international revenues are currently not significant.

### Liquidity and Capital Resources

The Company continues to expand its direct sales offices and dealer network, which has required and is expected to continue to require working capital for increased accounts receivable and inventories. During the first three months of 1997, despite the expansion of the Company's sales channels, including the integration of NTL Corporation, dba ComNet of Ohio, which was acquired in November 1996, accounts receivable and inventories decreased approximately $650,000. This decrease reflects the Company's moves to tighten credit on its customers and to place stricter controls on inventory purchases. In addition, the Company's capital expenditures totaled $1.7 million in the first quarter of 1997. The Company intends to continue to make significant capital expenditures during 1997, principally relating to improvement of the Company's management information systems. At March 31, 1997, the Company had $41.8 million in cash and equivalents, which represents an increase of approximately $2.9 million from December 31, 1996.

The Company has a loan agreement with Bank One, Arizona, NA. which provides for a $7.0 million, unsecured revolving line of credit. The credit facility is annually renewable and is available through July 31, 1997. Under the credit facility, the Company has the option to borrow at a prime rate or adjusted LIBOR interest rate. The credit facility is being used primarily to support international letters of credit to suppliers.

During the third quarter of 1995, the Company completed a secondary stock offering. A portion of the net proceeds from that offering have been used, and may continue to be used, to finance strategic acquisitions or corporate alliances. In April, 1997, the Company announced a plan to repurchase up to 1,450,000 shares of its common stock, which may require significant outlays of available cash.

The Company offers to its customers lease financing and other services, including its Totalease program, through its Inter-Tel Leasing subsidiary. The Company funds its Totalease program in part through the sale to financial institutions of rental income streams under the leases. Resold Totalease rentals totaling $75.8 million and $66.0 million remain unbilled at March 31, 1997 and December 31, 1996, respectively. The Company is obligated to repurchase such income streams in the event of defaults by lease customers and, accordingly, maintains reserves based upon loss experience and past due accounts. Although the Company to date has been able to resell the rental streams from leases under the Totalease program profitably and on a substantially current basis, the timing and profitability of lease resales could impact the Company's business and operating results, particularly in an environment of fluctuating interest rates. If the Company is required to repurchase rental streams and realize losses thereon in amounts exceeding its reserves, its operating results will be adversely affected.

The Company believes that its working capital and credit facilities will be sufficient to fund purchases of capital equipment, to finance cash acquisitions, and to repurchase shares of the Company's common stock which the Company may consider and to provide adequate working capital for the foreseeable future. However, to the extent that additional funds are required in the future to address working capital needs and to provide funding for capital expenditures, expansion of the business or additional acquisitions, the Company will seek additional financing. There can be no assurance that additional financing will be available when required or on acceptable terms.

**Factors That May Affect Results of Future Operations**

In evaluating the Company's business, shareholders should carefully consider the following factors in addition to the other information presented in this Form 10-Q.

*Rapid Technological Change and Dependence on New and Timely Product Introductions*

The market for the Company's software, products and services is characterized by rapid technological change and continuing demand for new products, features and applications. Current competitors or new market entrants may develop new products or product features that could adversely affect the competitive position of the Company's products. Accordingly, the timely introduction of new products and product features, as well as new telecommunications applications, will be a key factor in the Company's future success. Occasionally, new products contain undetected errors or "bugs" when released. Such bugs may result from defects contained in software products offered by the Company's suppliers or other third parties that are intended to be compatible with the Company's products, over which the Company has little or no control. Although the Company seeks to minimize the number of bugs in its products by its test procedures and strict quality control, there can be no assurance that its new products will be error free when introduced. Any significant delay in the commercial introduction of the Company's products due to bugs, any design modifications required to correct bugs or any impairment of customer satisfaction as a result of bugs could have a material adverse effect on the Company's business and operating results. In addition, new products often take several months before their manufacturing costs stabilize, which may adversely affect operating results for a period of time following introduction.

During the past twelve months, the Company introduced ISDN on its *AXXESS* digital communication platform, expanded the size of the *AXXESS* and Inter-Tel Axxent platforms, introduced a number of upgrades to its existing *AXXESSORY Talk* and IVX-500 voice processing platforms and announced the introduction of the Vocal'Net Server product. In the event that the Company were to fail to successfully introduce new software, products or services or upgrades to its existing systems or products on a regular and timely basis, demand for the Company's existing software, products and services could decline, which could have a material adverse effect on the Company's business and operating results. Additionally, there can be no guaranty that future costs of accessibility, lack of capacity or voice transmission quality of the Internet will not adversely affect the ability of the Company to deliver all Internet products and services on a cost effective basis. There can be no assurance that the Company will be able to successfully develop new software, products, services, technologies and applications on a timely basis as required by changing market needs or that new software or products or enhancements thereto, including its recently announced products and upgrades, when introduced by the Company, will achieve market acceptance.

The Company has recently developed and continues to develop products designed to address the emerging market for the convergence of voice and data applications, or computer telephony integration. If the computer telephony integration ("CTI") market fails to develop or grows more slowly than the Company anticipates, or if the Company is unable for any reason to capitalize on this emerging market opportunity, the Company's business and operating results could be materially adversely affected.

*Dependence Upon Contract Manufacturers and Component Suppliers*

Certain components used in the Company's digital communication platforms, including certain microprocessors, integrated circuits, power supplies and voice processing interface cards, are currently available from a single source or limited sources of supply, and product availability could be limited. In addition, the Company currently manufactures its products through a limited number of contract manufacturers located in the United States, the Philippines and the People's Republic of China. Foreign manufacturing facilities are subject to changes in governmental policies, imposition of tariffs and import restrictions and other factors beyond the Company's control. Varian Associates, Inc. ("Varian") currently manufactures a significant portion of the Company's products at Varian's Tempe, Arizona facility, including substantially all of the printed circuit boards used in the *AXXESS* and Inter-Tel Axxent digital communications platforms. From time to time, the Company has experienced delays in the supply of components and finished goods, and there can be no assurance that the Company will not experience such delays in the future. The Company's reliance on third party manufacturers involves a number of additional risks, including reduced control over delivery schedules, quality assurance and costs. Any delay in delivery or shortage of supply of components or finished goods from Varian or any other supplier, or the Company's inability to develop in a timely manner alternative or additional sources if and when required, could damage the Company's relationships with current and prospective customers and could materially and adversely affect the Company's business and operating results. The Company has no long term agreements with its suppliers that require the suppliers to provide fixed quantities of components or finished goods at set prices. There can be no assurance that the Company will be able to continue to obtain components or finished goods in sufficient quantities or quality or on favorable pricing and delivery terms in the future.

*Competition*

The market for the Company's digital communications platforms is highly competitive and in recent periods has been characterized by pricing pressures and business consolidations. The Company's competitors include Lucent Technologies and Northern Telecom Limited ("NorTel"), as well as Comdial Corporation ("Comdial"), EXECUTONE Information Systems, Inc. ("Executone"), Mitel Corporation ("Mitel"), Panasonic, Siemens ROLM Communications Inc. ("ROLM"), Toshiba and others. The Company also competes against the regional Bell operating companies ("RBOCS"), which offer systems produced by one or more of the aforementioned competitors and also offer Centrex systems in which call processing facilities are provided through equipment located in the telephone company's central office. Competition by the RBOCs may increase significantly in the future, as the RBOCs have been granted the right to manufacture telephone systems and equipment themselves and/or to bundle the sale of equipment with telephone calling services.

The Telecommunication Act of 1996 and AT&T's announcement to divide itself into three enterprises has had an impact on competition in the communication industry. The Telecommunication Act of 1996 opened the market for telephone and cable television services, forcing telephone companies to open their networks to competitors and giving consumers a choice of local phone carriers. Conversely, local phone companies are now able to offer long distance services. In addition, cable companies can now offer telephone services and Internet access. These changes will increase competition in the communication industry and will create additional competition and opportunities in customer premise equipment as these new services and interfaces become available. As the Company enters the markets for local telephone service and Internet access, it will face additional competition from RBOCs and other providers, which have larger marketing and sales organizations, significantly greater financial and technical resources and a larger and more established customer base than the Company. In addition, RBOCs and other providers have greater name recognition, more established positions in the market and long standing relationships with customers. Therefore, there can be no assurance that the Company will compete successfully in these markets.

In the market for voice processing applications, including voice mail, the Company competes against Centigram Communications Corporation ("Centigram"), Octel Communications Corporation ("Octel"), Active Voice Corporation ("Active Voice"), Applied Voice Technology, Inc. ("AVT") and other competitors, including telephone systems manufacturers such as Lucent Technologies, NorTel and ROLM, which offer integrated voice processing systems under their own label as well as through various OEM arrangements. Certain of the Company's competitors may achieve marketing advantages by bundling their voice processing equipment with sales of telephone systems, or by designing their telephone systems so that they do not readily integrate with independent voice processing systems. Inter-Tel expects that the development of industry standards and the acceptance of open systems architectures in the voice processing market will reduce technical barriers to market entry and lead to increased competition.

In the market for long distance services, the Company competes against AT&T Corp., MCI Telecommunications Corporation, Sprint Corporation and other suppliers, certain of which also supply the long distance calling and network services that the Company resells. Although the Company acquires a variety of long distance calling services in bulk from certain long distance carriers, there can be no assurance that the Company will be able to purchase long distance calling services on favorable terms from one or more of such providers in the future. In addition, a substantial majority of prospective new long distance customers for the Company currently purchase long distance calling services from the Company's competitors. The Company believes that it is likely to face increased competition in the long distance calling services market as a result of telecommunications deregulation, which enables RBOCs to supply long distance calling and network services, and enables RBOCs and others to bundle long distance, local telephone and wireless services. Moreover, the Company expects to face increased competition in the future because low technical barriers to entry will allow new market entrants.

As Inter-Tel develops more server-based and CTI telecommunications products, Inter-Tel's competition will be the large computer software companies, such as IBM (Lotus), and Microsoft. In addition, the server-based telephony, internet telephony and CTI markets have shown increasing competition from small start-up software companies.

Many of the Company's competitors are substantially larger, and have significantly greater financial and technical resources, name recognition and marketing and distribution capabilities, than the Company. The Company expects that competition will continue to be intense in the markets addressed by its products and services, and there can be no assurance that the Company will be able to compete successfully in the future.

*Management of Growth; Implementation of New Management Information Systems*

The growth in the Company's business has placed, and is expected to continue to place, a significant strain on the Company's personnel, management and other resources. The Company's ability to manage any future growth effectively will require it to attract, train, motivate and manage new employees successfully, to integrate new employees into its overall operations and to continue to improve its operational, financial and management information systems.

The Company implemented a new MIS system late in 1995. The MIS system significantly affected many aspects of the Company's business, including its accounting, operations, purchasing, sales and marketing functions. Since the date of implementation, the Company has experienced difficulty with the new MIS system software, which increased the Company's costs, had an adverse effect on the Company's ability to provide products and services to its customers on a timely basis and caused delays in coordinating accounting and financial results. During the fourth quarter of 1996, the Company determined that the limitations of the existing system software would prevent Inter-Tel from establishing an integrated and centralized dispatch and telemarketing center.

As a result, during the fourth quarter of 1996, the Company decided to replace its MIS system software with an integrated solution from a more established vendor and accordingly has written off the software license and implementation costs relating to the system software being replaced. Inter-Tel has signed an agreement with a large, established software and database vendor to implement, maintain and support alternate MIS system software to be utilized throughout the Company. Inter-Tel believes that such action was necessary to allow for the stability and growth of Inter-Tel.

The actions to replace the MIS system software could result in additional costs and delays in obtaining a fully functional MIS system, including but not limited to additional or alternate hardware and software required, but not available in the current system configuration, and additional personnel, which could have a material adverse effect on the company's business and operating results. In addition, implementation of this system software and the transition from the current system software to the new information system software will require substantial financial resources and personnel.

The Company has made strategic acquisitions in the past and expects to continue to do so in the future. Acquisitions require a significant amount of the Company's management attention and financial and operational resources, all of which are limited. The integration of acquired entities may also result in unexpected costs and disruptions, and significant fluctuations in, or reduced predictability of, operating results from period to period. There can be no assurance that an acquisition will not adversely affect the business relationships of the Company or the acquired entity with their respective suppliers or customers. Further, there can be no assurance that the Company will successfully integrate the acquired operations or achieve any of the intended benefits of an acquisition. The Company's failure to manage its growth effectively could have a material adverse effect on its business and operating results.

*Product Protection and Infringement*

The Company's future success is dependent in part upon its proprietary technology. The Company relies principally on copyright and trade secret law and contractual provisions to protect its intellectual property. There can be no assurance that any copyright owned by the Company will not be invalidated, circumvented or challenged or that the rights granted thereunder will provide competitive advantages to the Company. Further, there can be no assurance that others will not develop technologies that are similar or superior to the Company's technology or that duplicate the Company's technology.

As the Company expands its international operations, effective intellectual property protection may be unavailable or limited in certain foreign countries. There can be no assurance that the steps taken by the Company will prevent misappropriation of its technology. Litigation may be necessary in the future to enforce the Company's intellectual property rights, to protect the Company's trade secrets, to determine the validity and scope of the proprietary rights of others, or to defend against claims of infringement or invalidity. Such litigation or delays in product introductions or decisions to discontinue development, manufacture or sale of such products, could result in substantial costs and diversion of resources and could have a material adverse effect on the Company's business and operating results.

*Reliance on Dealer Network*

A substantial portion of the Company's net sales are made through its network of independent dealers. The company faces intense competition from other telephone system and voice processing system manufacturers for such dealers' business, as most of the Company's dealers carry products which compete with the Company's products. The Company has no exclusive agreements with any of its dealers. The loss of any significant dealer or group of dealers, or any event or condition adversely affecting the Company's dealer network, could have a material adverse effect on the Company's business and operating results.

*Risks of Providing Long Distance and Network Services*

Inter-Tel depends on a reliable supply of telecommunications services and information from several long distance carriers. Because it does not own transmission facilities, the Company relies on long distance carriers for the provision of network services to the Company's customers and for billing information. Long distance services are subject to extensive and uncertain governmental regulation on both the federal and state level. There can be no assurance that the promulgation of certain regulations will not adversely affect the Company's business and operating results. Contracts with the long distance carriers from which the Company currently resells services typically have a multi-year term in which the Company's prices are relatively fixed and have minimum use requirements. There can be no assurance that the Company will meet minimum use commitments, will be able to negotiate lower rates with carriers in the event of any decrease in end user rates or will be able to extend its contracts with long distance carriers at prices favorable to the Company. The Company's ability to continue to expand its long distance service operations will depend on its ability to continue to secure reliable long distance services from a number of long distance carriers and the willingness of such carriers to continue to make telecommunications services and billing information available to the Company on favorable terms.

*Dependence on Key Personnel*

The Company is dependent on the continued service of, and its ability to attract and retain, qualified technical, marketing, sales and managerial personnel. The competition for such personnel is intense, and the loss of any of such persons, as well as the failure to recruit additional key technical and sales personnel in a timely manner, would have a material adverse effect on the Company's business and operating results. There can be no assurance that the Company will be able to continue to attract and retain the qualified personnel necessary for the development of its business.

*Possible Volatility of Stock Price*

The Company believes that factors such as announcements of developments relating to the Company's business, fluctuations in the Company's operating results, general conditions in the telecommunications industry or the worldwide economy, changes in legislation or regulation affecting the telecommunications industry, an outbreak of hostilities, a shortfall in revenue or earnings from securities analysts' expectations, announcements of technological innovations or new products or enhancements by the Company or its competitors, developments in intellectual property rights and developments in the Company's relationships with its customers and suppliers could cause the price of the Company's Common Stock to fluctuate, perhaps substantially. Many of such factors are beyond the Company's control. In addition, in recent years the stock market in general, and the market for shares of technology stocks in particular, have experienced extreme price fluctuations, which have often been unrelated to the operating performance of affected companies. There can be no assurance that the market price of the Company's Common Stock will not experience significant fluctuations in the future, including fluctuations that are unrelated to the Company's performance.

*Potential Fluctuations In Quarterly Results; Limited Backlog*

The Company's quarterly operating results depend upon a variety of factors, including the volume and timing of orders received during the quarter, the mix of products sold, mix of distribution channels, general economic conditions, patterns of capital spending by customers, the timing of new product announcements and releases by the Company and its competitors, pricing pressures and the availability and cost of products and components from the Company's suppliers. The Company's customers typically require immediate shipment and installation of platforms and software. As a result, the Company has historically operated with a relatively small backlog, and sales and operating results in any quarter are principally dependent on orders booked and shipped in that quarter. Moreover, market demand for investment in capital equipment such as digital communication platforms and associated call processing and voice processing software applications is largely dependent on general economic conditions, and can vary significantly as a result of changing conditions in the economy as a whole. The Company's expense levels are based in part on expectations of future sales and, if sales levels do not meet expectations, operating results could be adversely affected. Because sales of digital communication platforms through the Company's dealers produce lower gross margins than sales through the Company's direct sales organization, operating results will vary based upon the mix of sales through direct and indirect channels. Although the Company to date has been able to resell the rental streams from leases under its Totalease program profitably and on a substantially current basis, the timing and profitability of lease resales from quarter to quarter could impact operating results, particularly in an environment of fluctuating interest rates. Long distance sales have, in recent periods, grown at a faster rate than the Company's overall net sales and such sales have lower gross margins than the Company's core business. As a result, gross margins could be adversely affected in the event that long distance calling services continue to increase as a percentage of net sales. In addition, the Company is subject to seasonality in its operating results, as net sales for the first and third quarters are frequently less than those experienced in the fourth and second quarters, respectively. As a result of these and other factors, the Company has in the past and could in the future experience fluctuations in sales and operating results on a quarterly basis. See "Management's Discussion and Analysis of Financial Condition and Results of Operations."

*Concentration of Ownership*

As of March 31, 1997, the Company's Chairman of the Board of Directors and Chief Executive Officer beneficially owned approximately 21% of the outstanding shares of the Common Stock. As a result, he has the ability to exercise significant influence over all matters requiring shareholder approval. In addition, the concentration of ownership could have the effect of delaying or preventing a change in control of the Company.

**INTER-TEL, INCORPORATED AND SUBSIDIARIES**

**PART II. OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS--Not Applicable**

**ITEM 2. CHANGES IN SECURITIES--Not Applicable**

**ITEM 3. DEFAULTS ON SENIOR SECURITIES--Not Applicable**

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITIES**

## HOLDERS

1. On April 23, 1997, at the Company's annual meeting of shareholders, the shareholders of the Company elected the following directors, each of whom was a nominee of the Company:

| Name | Votes For | Votes Withheld |
|---|---|---|
| Steven G. Mihaylo | 10,141,397 | 226,028 |
| J. Robert Anderson | 10,141,275 | 226,150 |
| Gary D. Edens | 10,141,247 | 226,178 |
| Maurice H. Esperseth | 10,135,247 | 232,178 |
| C. Roland Haden | 10,141,547 | 225,878 |
| Norman Stout | 10,140,747 | 226,678 |

2. The proposal to approve the Inter-Tel, Incorporated 1997 Long-Term Incentive Plan received the following votes:

| | Votes For | Percentage |
|---|---|---|
| For: | 5,367,052 | 51.77% |
| Against: | 2,692,039 | 25.97% |
| Abstain: | 43,392 | 0.42% |
| Broker Non Vote: | 2,264,942 | 21.84% |

3. The proposal to approve the Inter-Tel, Incorporated Employee Stock Purchase Plan received the following votes:

| | Votes For | Percentage |
|---|---|---|
| For: | 7,484,179 | 72.19% |
| Against: | 549,886 | 5.30% |
| Abstain: | 35,218 | 0.34% |
| Broker Non Vote: | 2,298,142 | 22.17% |

4. The proposal to approve adoption of an Amendment to Article IX, Paragraph 1 of the Company's Restated Articles of Incorporation regarding Indemnification received the following votes:

| | Votes For | Percentage |
|---|---|---|
| For: | 10,263,812 | 99.00% |
| Against: | 62,621 | 0.60% |
| Abstain: | 40,992 | 0.40% |
| Broker Non Vote: | 0 | 0.00% |

**ITEM 5. OTHER INFORMATION--Not Applicable**

**ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K:**

Exhibits:

| | |
|---|---|
| 11.1 | Computation of Earnings per Share |
| 27 | Financial Data Schedule |

Reports on Form 8-K:
No reports filed during quarter

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## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

INTER-TEL, INCORPORATED

Date May 13, 1997

/s/ Steven G. Mihaylo
Steven G. Mihaylo
Chairman of the Board and
Chief Executive Officer

Date May 13, 1997

/s/ Kurt R. Kneip
Kurt R. Kneip
Vice President and
Chief Financial Officer

EXHIBIT 11.1

**STATEMENT RE: COMPUTATION OF PER SHARE EARNINGS**

| (In thousands except per share amounts) | Three Months Ended March 31, 1997 | March 31, 1996 |
|---|---|---|
| **PRIMARY** | | |
| Average shares outstanding | 12,950 | 12,821 |
| Net effect of dilutive stock options-- based on the treasury stock method using average market price | 396 | 472 |
| **TOTAL** | 13,346 | 13,293 |
| Net income | $ 2,670 | $ 2,899 |
| Per share amount | $ .20 | $ .22 |
| **FULLY DILUTED** | | |
| Average shares outstanding | 12,950 | 12,821 |
| Net effect of dilutive stock options-- based on the treasury stock method using the quarter-end market price, if higher than the average market price | 396 | 543 |
| **TOTAL** | 13,346 | 13,364 |
| Net income | $ 2,670 | $ 2,899 |
| Per share amount | $ .20 | $ .22 |

**INTER-TEL, INCORPORATED AND SUBSIDIARIES**
**FINANCIAL DATA SCHEDULE**
**EXHIBIT 27**

**THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE INTER-TEL, INCORPORATED AND SUBSIDIARIES FINANCIAL STATEMENTS FOR THE QUARTER ENDED MARCH 31, 1997 AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS**

| Item Number | Item Description | 3-31-97 ($000's) |
|---|---|---|
| 5-02(1) | Cash and cash items | 41843 |
| 5-02(2) | Marketable securities | 0 |
| 5-02(3)(a)(1) | Notes and accounts receivable--trade | 32802 |
| 5-02(4) | Allowance for doubtful accounts | 3234 |
| 5-02(6) | Inventory | 21060 |
| 5-02(9) | Total current assets | 109287 |
| 5-02(13) | Property, plant and equipment | 28324 |
| 5-02(14) | Accumulated depreciation | 16371 |
| 5-02(18) | Total assets | 135147 |
| 5-02(21) | Total current liabilities | 24786 |
| 5-02(22) | Bonds, mortgages and similar debt | 0 |
| 5-02(28) | Preferred stock - mandatory redemption | 0 |
| 5-02(29) | Preferred stock - no mandatory redemption | 0 |
| 5-02(3) | Common stock | 59948 |
| 5-02(31) | Other stockholders' equity | 37608 |
| 5-02(32) | Total liabilities and stockholders' equity | 135147 |
| 5-03(b)1(a) | Net sales of tangible products | 50322 |
| 5-03(b)1 | Total revenue | 50322 |
| 5-03(b)2(a) | Cost of tangible goods sold | 28152 |
| 5-03(b)2 | Total costs and expenses applicable to sales and revenues | 28152 |
| 5-03(b)3 | Other costs and expenses | 0 |
| 5-03(b)5 | Provision for doubtful accounts and notes | 0 |
| 5-03(b)(8) | Interest and amortization of debt discount | 7 |
| 5-03(b)(10) | Income before taxes and other items | 4489 |
| 5-03(b)(11) | Income tax expense | 1819 |
| 5-03(b)(14) | Income continuing operations | 2670 |
| 5-03(b)(15) | Discontinued operations | 0 |
| 5-03(b)(17) | Extraordinary items | 0 |
| 5-03(b)(18) | Cumulative effect-changes in accounting principles | 0 |
| 5-03(b)(19) | Net income | 2670 |
| 5-03(b)(20) | Earnings per share - primary | .20 |
| 5-03(b)(20) | Earnings per share - fully diluted | .20 |

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

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FORM 10-Q

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934

| For the quarter ended | Commission File Number: |
|---|---|
| June 30, 1997 | 0-10211 |

INTER-TEL, INCORPORATED

Incorporated in the State of Arizona I.R.S. No. 86-0220994

120 North 44th Street, Suite 200
Phoenix, Arizona 85034-1822

(602) 302-8900

Common Stock
(12,995,478 shares outstanding as of June 30, 1997)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter periods that the registrant was required file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No __

INDEX

## INTER-TEL, INCORPORATED AND SUBSIDIARIES

## PART I. FINANCIAL INFORMATION

## INTER-TEL, INCORPORATED AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)

| (In thousands) | June 30, 1997 | December 31, 1996 |
|---|---|---|
| **ASSETS** | | |
| **CURRENT ASSETS** | | |
| Cash and equivalents | $25,673 | $38,936 |
| Accounts receivable - net | 29,035 | 29,998 |
| Inventories | 23,001 | 21,280 |
| Net investment in sales-leases | 8,103 | 8,243 |
| Prepaid expenses and other assets | 5,005 | 7,008 |
| TOTAL CURRENT ASSETS | 90,817 | 105,465 |
| **PROPERTY & EQUIPMENT** | 15,660 | 11,189 |
| **OTHER ASSETS** | 17,071 | 15,957 |
| | $123,548 | $132,611 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | |
| **CURRENT LIABILITIES** | | |
| Accounts payable | 10,814 | $8,915 |
| Other current liabilities | 15,330 | 16,841 |
| TOTAL CURRENT LIABILITIES | 26,144 | 25,756 |
| **DEFERRED TAXES AND OTHER LIABILITIES** | 13,637 | 11,921 |
| **SHAREHOLDERS' EQUITY** | | |
| Common stock | 60,115 | 59,875 |
| Retained earnings | 39,630 | 35,464 |
| Equity adjustment for foreign currency translation | (520) | (359) |
| | 99,225 | 94,980 |
| Less: | | |
| Treasury stock at cost | (15,458) | -- |
| Receivable from Employee Stock Ownership Trust | -- | (46) |
| TOTAL SHAREHOLDERS' EQUITY | 83,767 | 94,934 |
| | $123,548 | $132,611 |

## INTER-TEL, INCORPORATED AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME (Unaudited)

| (In thousands, except per share amounts) | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 1997 | 1996 | 1997 | 1996 |
| **NET SALES** | $54,823 | $43,736 | $105,145 | $85,949 |
| Cost of sales | 3[illegible],422 | 24,628 | 58,574 | 47,529 |
| **GROSS PROFIT** | 24,401 | 19,108 | 46,571 | 38,420 |
| Research & development | 2,134 | 1,661 | 3,979 | 3,365 |
| Selling, general and administrative | 17,139 | 13,138 | 33,191 | 26,338 |
| | 19,273 | 14,799 | 37,170 | 29,703 |
| **OPERATING INCOME** | 5,128 | 4,309 | 9,401 | 8,717 |
| Interest and other income | 595 | 517 | 818 | 963 |
| Interest expense | (17) | (29) | (24) | (33) |
| **INCOME BEFORE TAXES** | 5,706 | 4,797 | 10,195 | 9,647 |
| Income taxes | 2,282 | 2,013 | 4,101 | 3,964 |
| **NET INCOME** | $3,424 | $2,784 | $6,094 | $5,683 |
| **NET INCOME PER SHARE** | $.26 | $.21 | $.46 | $.43 |
| Average number of shares outstanding | 13,132 | 13,431 | 13,239 | 13,358 |

**INTER-TEL, INCORPORATED AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)**

| (In thousands, except per share amounts) | Three Months Ended June 30, 1997 | Three Months Ended June 30, 1996 | Six Months Ended June 30, 1997 | Six Months Ended June 30, 1996 |
|---|---|---|---|---|
| **OPERATING ACTIVITIES** | | | | |
| **NET INCOME** | $3,424 | $2,784 | $6,094 | $5,683 |
| Adjustments to reflect operating activities: | | | | |
| Depreciation and amortization | 1,171 | 973 | 2,240 | 1,894 |
| Changes in operating assets and liabilities | (1,279) | (8,906) | (1,445) | (16,136) |
| Other | 2,439 | 565 | 4,234 | 2,695 |
| **NET CASH PROVIDED BY/(USED IN) OPERATING ACTIVITIES** | 5,755 | (4,584) | 11,123 | (5,864) |
| **INVESTING ACTIVITIES** | | | | |
| Proceeds from disposal of property and equipment | 5 | 132 | 5 | 132 |
| Cash used in acquisition | -- | -- | (825) | -- |
| Additions to property and equipment | (4,711) | (873) | (6,420) | (2,470) |
| **NET CASH USED IN INVESTING ACTIVITIES** | (4,706) | (741) | (7,240) | (2,338) |
| **FINANCING ACTIVITIES** | | | | |
| Payments for repurchase of common stock | (17,493) | -- | (17,493) | -- |
| Proceeds from exercise of stock options | 274 | 397 | 347 | 486 |
| **NET CASH (USED IN)/PROVIDED BY FINANCING ACTIVITIES** | (17,219) | 397 | (17,146) | 486 |
| **DECREASE IN CASH AND EQUIVALENTS** | (16,170) | (4,928) | (13,263) | (7,716) |
| **CASH AND EQUIVALENTS AT BEGINNING OF PERIOD** | 41,843 | 36,852 | 38,936 | 39,640 |
| **CASH AND EQUIVALENTS AT END OF PERIOD** | $25,673 | $31,924 | $25,673 | $31,924 |

## INTER-TEL, INCORPORATED AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

June 30, 1997

### NOTE A—BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of the results for the interim periods presented have been included. Operating results for the three and six months ended June 30, 1997 are not necessarily indicative of the results that may be expected for the year ending December 31, 1997. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's annual report on Form 10-K for the year ended December 31, 1996.

### NOTE B—INCOME PER SHARE

Primary earnings per share assume that outstanding common shares were increased by shares issuable upon the exercise of all outstanding stock options to which market price exceeds exercise price less shares which could have been purchased with related proceeds.

In February 1997, the Financial Accounting Standards Board issued Statement No. 128, *Earnings per Share*, which is required to be adopted on December 31, 1997. At that time, the Company will be required to change the method currently used to compute earnings per share and to restate all prior periods. Under the new requirements for calculating primary earnings per share, the dilutive effect of stock options will be excluded. The impact is expected to result in an increase in primary earnings per share for both the second quarter and six months ended June 30, 1997 and June 30, 1996 of $.01 and $.01 per share, respectively. The impact of Statement 128 on the calculation of fully diluted earnings per share for these quarters is not expected to be material.

### NOTE C—TREASURY STOCK

During the second quarter of 1997, the Company initiated a stock repurchase program under which the Board of Directors authorized the repurchase of up to 1,470,000 shares of the Company's common stock. The Company expended approximately $17.5 million for stock repurchases in the second quarter of 1997, which was funded primarily by existing cash balances. The Company reissued treasury shares with a cost basis of approximately $2.0 million relating to stock option exercises and issuances. The proceeds received for the treasury stock reissued was less than its cost basis. Accordingly, the difference has been recorded as a reduction to retained earnings.

PART I.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### Overview

Inter-Tel is a single point of contact, full service solutions integrator providing *AXXESS* and Axxent digital communication platforms, *AxxessoryTalk* voice processing platforms, call processing software and voice processing software along with various other productivity enhancing software applications, computer-telephony integration ("CTI"), network services and long distance calling services, as well as maintenance, leasing and support services. The Company's Common Stock is quoted on the Nasdaq National Market under the symbol INTL.

This Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Actual results could differ materially from those projected in the forward-looking statements as a result of many risk factors, including, without limitation, those set forth under "Factors That May Affect Future Results Of Operations" below.

### Results of Operations

Net sales for the second quarter of 1997 increased 25.3% to $54.8 million from $43.7 million in the second quarter of 1996. Net sales increased 22.3% to $105.1 million in the first six months of 1997 from $85.9 million in the first six months of 1996. For the quarter and six months ended June 30, 1997, sales from wholesale distribution and direct sales offices accounted for approximately $8.2 million and $13.4 million of the increases, respectively. The remaining increases occurred in long distance sales and other operations.

The following table sets forth certain statement of operations data of the Company expressed as a percentage of net sales for the periods indicated:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 1997 | 1996 | 1997 | 1996 |
| Net Sales | 100.0% | 100.0% | 100.0% | 100.0% |
| Cost of Sales | 55.5 | 56.3 | 55.7 | 55.3 |
| Gross profit | 44.5 | 43.7 | 44.3 | 44.7 |
| Research and development | 3.9 | 3.8 | 3.8 | 3.9 |
| Selling, general and administrative | 31.3 | 30.0 | 31.6 | 30.7 |
| Operating income | 9.3 | 9.9 | 8.9 | 10.1 |
| Interest and other income | 1.1 | 1.2 | 0.8 | 1.1 |
| Interest expense | 0.0 | 0.1 | 0.0 | -- |
| Income taxes | 4.2 | 4.6 | 3.9 | 4.6 |
| Net income | 6.2% | 6.4% | 5.8% | 6.6% |

Gross profit for the second quarter of 1997 increased 27.7% to $24.4 million, or 44.5% of net sales, from $19.1 million, or 43.7% of net sales, for the second quarter of 1996. Gross profit increased to $46.6 million, or 44.3% of net sales, in the first six months of 199_ from $38.4 million, or 44.7% of net sales, in the first six months of 1996. Gross margin increased in the second quarter of 1997 primarily as a result of higher sales of *AXXESS* digital communication platforms, call processing software and voice processing software as a percentage of net sales, which was offset in part by a higher percentage of sales through dealers and increased sales of the Company's network services and long distance calling services, which generally have a lower gross margin than sales of the Company's other products.

Research and development expenses for the second quarter of 1997 increased to $2.1 million, or 3.9% of net sales, from $1.7 million, or 3.8% of net sales, for the second quarter of 1996. Research and development expenses increased to $4.0 million, or 3.8% of net sales, in the first six months of 1997 from $3.4 million, or 3.9% of net sales, in the first six months of 1996. The increases in absolute dollars in both periods were primarily attributable to expenses relating to the development and introduction of new products, including continuing development and improvement of AXXESS digital communication platforms, call processing and voice processing software, CTI products, unified messaging, and TCP/IP intranet and internet voice solutions (Vocal'Net and Inter-Tel.net). The Company expects that research and development expenses will continue to increase in absolute dollars as the Company continues to develop new software and to enhance existing technologies and products. These expenses may vary, however, as a percentage of net sales.

Selling, general and administrative expenses for the second quarter of 1997 increased to $17.1 million, or 31.3% of net sales, from $13.1 million, or 30.0% of net sales, for the second quarter of 1996. Selling, general and administrative expenses increased to $33.2 million, or 31.6% of net sales, in the first six months of 1997 from $26.3 million, or 30.6% of net sales, in the first six months of 1996. The increases, both in dollars and as a percentage of sales, for the quarter and six months ended June 30, 1997, were attributable in part to cost associated with increases in sales from the direct sales offices, which typically generate higher selling, general and administrative expenses compared to sales through dealer channels. The Company also has expanded its technical training staff, increased its receivables reserves, and continues to hire and train additional sales personnel throughout Inter-Tel's direct sales offices and to provide additional marketing resources and sales personnel for the expanded dealer network and for network services and long distance services. Higher sales commissions were also paid based upon increased levels of net sales. The Company expects that selling, general and administrative expenses will continue to increase in absolute dollars, but may vary as a percentage of net sales.

Other income in both periods consisted primarily of interest income and foreign exchange rate gains and losses. Income from interest decreased slightly in both comparable periods of 1997 based on lower invested funds. Other changes are primarily due to differences in net foreign exchange rate gains and losses.

Net income for the second quarter increased 23.0% to $3.4 million ($.26 per share) compared to net income of $2.8 million ($.21 per share) for the second quarter of 1996. Net income increased 7.2% to $6.1 million, or $.46 per share, in the first six months of 1997 from $5.7 million, or $.43 per share, in the first six months of 1996.

### Inflation/Currency Fluctuation

Inflation and currency fluctuations have not previously had a material impact on Inter-Tel's operations. International procurement agreements have traditionally been denominated in U.S. currency. Moreover, a significant amount of contract manufacturing has been moved to domestic sources. The expansion of international operations in the United Kingdom and Europe and increased sales, if any, in Japan and Asia and elsewhere could result in higher international sales as a percentage of total revenues, but international revenues are currently not significant.

### Liquidity and Capital Resources

At June 30, 1997, the Company had $25.7 million in cash and equivalents, which represents a decrease of approximately $13.3 million from December 31, 1996. The Company maintains a $7.0 million, unsecured revolving line of credit with Bank One, Arizona, NA. The credit facility is annually renewable and is available through July 31, 1998. Under the credit facility, the Company has the option to borrow at a prime rate or adjusted LIBOR interest rate. Historically, the credit facility has been used primarily to support international letters of credit to suppliers.

Net cash provided by operating activities totaled $11.1 for the six months ended June 30, 1997, compared to net cash used by operating activities of $5.9 million for the same period in 1996. The increase in cash generated was primarily the result of profitable operations and reduced accounts receivable, which were partially offset by higher inventory levels. During the first six months of 1997, accounts receivable decreased approximately $963,000, while inventories increased approximately $1.7 million. Inventories increased in part due to higher revenues and related requirements to support additional sales locations. The Company continues to expand its dealer network, which has required and is expected to continue to require working capital for increased accounts receivable and inventories.

Net cash used in investing activities, primarily in the form of capital expenditures, was $7.2 million and $2.3 million for the six months ended June 30, 1997 and 1996, respectively. Capital expenditures and cash used in an acquisition totaled approximately $6.4 million and $825,000, respectively, in the first six months of 1997. The Company anticipates additional capital expenditures during 1997, principally relating to expansion of facilities, equipment and management information systems used in operations.

Net cash used in financing activities totaled $17.1 million compared to net cash generated of $486,000 for the same period in 1996. During the second quarter of 1997, the Company initiated a stock repurchase program under which the Board of Directors authorized the repurchase of up to 1,470,000 shares of the Company's common stock. The Company expended approximately $17.5 million for stock repurchases in the second quarter of 1997, which was funded primarily by existing cash balances. The Company reissued treasury shares with a cost basis of approximately $2.0 million relating to stock option exercises and issuances. The proceeds received for the treasury stock reissued was less than its cost basis. Accordingly, the difference has been recorded as a reduction to retained earnings.

The Company offers to its customers lease financing and other services, including its Totalease program, through its Inter-Tel Leasing subsidiary. The Company funds these programs in part through the sale to financial institutions of rental income streams under the leases. Resold lease rentals totaling $84.7 million and $66.0 million remain unbilled at June 30, 1997 and December 31, 1996, respectively. The Company is obligated to repurchase such income streams in the event of defaults by lease customers and, accordingly, maintains reserves based upon loss experience and past due accounts. Although the Company to date has been able to resell the rental streams from leases under its lease programs profitably and on a substantially current basis, the timing and profitability of lease resales could impact the Company's business and operating results, particularly in an environment of fluctuating interest rates and economic uncertainty. If the Company is required to repurchase rental streams and realize losses thereon in amounts exceeding its reserves, its operating results will be adversely affected.

The Company believes that its existing working capital, anticipated cash flows from operations and credit facilities will be sufficient to fund purchases of capital equipment, finance cash acquisitions, repurchase shares of the Company's common stock which the Company may consider and provide adequate working capital for the foreseeable future. However, to the extent that additional funds are required in the future to address working capital needs and to provide funding for capital expenditures, stock repurchases, expansion of the business or additional acquisitions, the Company will seek additional financing. There can be no assurance that additional financing will be available when required or on acceptable terms.

**Factors That May Affect Results of Future Operations**

In evaluating the Company's business, shareholders should carefully consider the following factors in addition to the other information presented in this Form 10-Q.

*Rapid Technological Change And Dependence On New And Timely Product Introductions*

The market for the Company's software, products and services is characterized by rapid technological change and continuing demand for new products, features and applications. Current competitors or new market entrants may develop new products or product features that could adversely affect the competitive position of the Company's products. Accordingly, the timely introduction of new products and product features, as well as new telecommunications applications, will be a key factor in the Company's future success. Occasionally, new products contain undetected errors or "bugs" when released. Such bugs may result from defects contained in software products offered by the Company's suppliers or other third parties that are intended to be compatible with the Company's products, over which the Company has little or no control. Although the Company seeks to minimize the number of bugs in its products by its test procedures and strict quality control, there can be no assurance that its new products will be error free when introduced. Any significant delay in the commercial introduction of the Company's products due to bugs, any design modifications required to correct bugs or any impairment of customer satisfaction as a result of bugs could have a material adverse effect on the Company's business and operating results. In addition, new products often take several months before their manufacturing costs stabilize, which may adversely affect operating results for a period of time following introduction.

During the past twelve months, the Company introduced ISDN on its AXXESS digital communication platform, expanded the size of the Inter-Tel Axxent platform, introduced a number of upgrades to its existing AXXESSORY Talk and IVX-500 voice processing platforms and announced the introduction of the Vocal'Net Server product. In the event that the Company were to fail to successfully introduce new software, products or services or upgrades to its existing systems or products on a regular and timely basis, demand for the Company's existing software, products and services could decline, which could have a material adverse effect on the Company's business and operating results. Additionally, there can be no guaranty that future costs of accessibility, lack of capacity or voice transmission quality of the Internet will not adversely affect the ability of the Company to deliver all Internet products and services on a cost effective basis. There can be no assurance that the Company will be able to successfully develop new software, products, services, technologies and applications on a timely basis as required by changing market needs or that new software or products or enhancements thereto, including its recently announced products and upgrades, when introduced by the Company, will achieve market acceptance.

The Company has recently developed and continues to develop products designed to address the emerging market for the convergence of voice and data applications, or computer telephony integration. If the computer telephony integration ("CTI") market fails to develop or grows more slowly than the Company anticipates, or if the Company is unable for any reason to capitalize on this emerging market opportunity, the Company's business and operating results could be materially adversely affected.

*Dependence Upon Contract Manufacturers and Component Suppliers*

Certain components used in the Company's digital communication platforms, including certain microprocessors, integrated circuits, power supplies and voice processing interface cards, are currently available from a single source or limited sources of supply, and product availability could be limited. In addition, the Company currently manufactures its products through a limited number of contract manufacturers located in the United States, the Philippines and the People's Republic of China. Foreign manufacturing facilities are subject to changes in governmental policies, imposition of tariffs and import restrictions and other factors beyond the Company's control. Varian Associates, Inc. ("Varian") currently manufactures a significant portion of the Company's products at Varian's Tempe, Arizona facility, including substantially all of the printed circuit boards used in the *AXXESS* and Inter-Tel Axxent digital communications platforms. From time to time, the Company has experienced delays in the supply of components and finished goods, and there can be no assurance that the Company will not experience such delays in the future. The Company's reliance on third party manufacturers involves a number of additional risks, including reduced control over delivery schedules, quality assurance and costs. Any delay in delivery or shortage of supply of components or finished goods from Varian or any other supplier, or the Company's inability to develop in a timely manner alternative or additional sources if and when required, could damage the Company's relationships with current and prospective customers and could materially and adversely affect the Company's business and operating results. The Company has no long term agreements with its suppliers that require the suppliers to provide fixed quantities of components or finished goods at set prices. There can be no assurance that the Company will be able to continue to obtain components or finished goods in sufficient quantities or quality or on favorable pricing and delivery terms in the future.

*Competition*

The market for the Company's digital communications platforms is highly competitive and in recent periods has been characterized by pricing pressures and business consolidations. The Company's competitors include Lucent Technologies and Northern Telecom Limited ("NorTel"), as well as Comdial Corporation ("Comdial"), EXECUTONE Information Systems, Inc. ("Executone"), Mitel Corporation ("Mitel"), Panasonic, Siemens ROLM Communications Inc. ("ROLM"), Toshiba and others. The Company also competes against the regional Bell operating companies ("RBOCs"), which offer systems produced by one or more of the aforementioned competitors and also offer Centrex systems in which call processing facilities are provided through equipment located in the telephone company's central office. Competition by the RBOCs may increase significantly in the future, as the RBOCs have been granted the right to manufacture telephone systems and equipment themselves and/or to bundle the sale of equipment with telephone calling services.

The Telecommunication Act of 1996 and the division of AT&T's operations into three enterprises has had an impact on competition in the communication industry. The Telecommunication Act of 1996 opened the market for telephone and cable television services, forcing telephone companies to open their networks to competitors and giving consumers a choice of local phone carriers. Conversely, local phone companies are now able to offer long distance services. In addition, cable television operators can now offer telephone services and Internet access. These changes will increase competition in the communication industry and will create additional competition and opportunities in customer premise equipment as these new services and interfaces become available. As the Company enters the markets for local telephone service and Internet access, it will face additional competition from RBOCs and other providers, which have larger marketing and sales organizations, significantly greater financial and technical resources and a larger and more established customer base than the Company. In addition, RBOCs and other providers have greater name recognition, more established positions in the market and long standing relationships with customers. Therefore, there can be no assurance that the Company will compete successfully in these markets.

In the market for voice processing applications, including voice mail, the Company competes against Centigram Communications Corporation ("Centigram"), Octel Communications Corporation ("Octel"), Active Voice Corporation ("Active Voice"), Applied Voice Technology, Inc. ("AVT") and other competitors, including telephone systems manufacturers such as Lucent Technologies (which has agreed to acquire Octel), NorTel and ROLM, which offer integrated voice processing systems under their own label as well as through various OEM arrangements. Certain of the Company's competitors may achieve marketing advantages by bundling their voice processing equipment with sales of telephone systems, or by designing their telephone systems so that they do not readily integrate with independent voice processing systems. Inter-Tel expects that the development of industry standards and the acceptance of open systems architectures in the voice processing market will reduce technical barriers to market entry and lead to increased competition.

In the market for long distance services, the Company competes against AT&T Corp., MCI Telecommunications Corporation, Sprint Corporation and other suppliers, certain of which also supply the long distance calling and network services that the Company resells. Although the Company acquires a variety of long distance calling services in bulk from certain long distance carriers, there can be no assurance that the Company will be able to purchase long distance calling services on favorable terms from one or more of such providers in the future. In addition, a substantial majority of prospective new long distance customers for the Company currently purchase long distance calling services from the Company's competitors. The Company believes that it is likely to face increased competition in the long distance calling services market as a result of telecommunications deregulation, which enables RBOCs to supply long distance calling and network services, and enables RBOCs and others to bundle long distance, local telephone and wireless services. Moreover, the Company expects to face increased competition in the future because low technical barriers to entry will allow new market entrants.

As Inter-Tel develops more server-based and CTI telecommunications products, Inter-Tel will face competition from large computer software companies, including IBM (Lotus), and Microsoft. In addition, the server-based telephony, internet telephony and CTI markets have shown increasing competition from small start-up software companies.

Many of the Company's competitors are substantially larger, and have significantly greater financial and technical resources, name recognition and marketing and distribution capabilities, than the Company. The Company expects that competition will continue to be intense in the markets addressed by its products and services, and there can be no assurance that the Company will be able to compete successfully in the future.

*Management of Growth; Implementation of New Management Information Systems*

The growth in the Company's business has placed, and is expected to continue to place, a significant strain on the Company's personnel, management and other resources. The Company's ability to manage any future growth effectively will require it to attract, train, motivate and manage new employees successfully, to integrate new employees into its overall operations and to continue to improve its operational, financial and management information systems.

The Company implemented a new MIS system late in 1995. The MIS system significantly affected many aspects of the Company's business, including its accounting, operations, purchasing, sales and marketing functions. Following the date of implementation, the Company experienced difficulty with the new MIS system software, which increased the Company's costs, had an adverse effect on the Company's ability to provide products and services to its customers on a timely basis and caused delays in coordinating accounting and financial results. During the fourth quarter of 1996, the Company determined that the limitations of the existing system software would prevent Inter-Tel from establishing an integrated and centralized dispatch and telemarketing center.

As a result, during the fourth quarter of 1996, the Company decided to replace its MIS system software with an integrated solution from a more established vendor and accordingly wrote off the software license and implementation costs relating to the system software being replaced. Inter-Tel signed an agreement with a large, established software and database vendor to implement, maintain and support alternate MIS system software to be utilized throughout the Company.

The actions to replace the MIS system software could result in additional costs and delays in obtaining a fully functional MIS system, including but not limited to additional or alternate hardware and software required, but not available in the current system configuration, and additional personnel, which could have a material adverse effect on the company's business and operating results. In addition, implementation of this system software and the transition from the current system software to the new information system software will require substantial financial resources and personnel.

The Company has made strategic acquisitions in the past and expects to continue to do so in the future. Acquisitions require a significant amount of the Company's management attention and financial and operational resources, all of which are limited. The integration of acquired entities may also result in unexpected costs and disruptions, and significant fluctuations in, or reduced predictability of, operating results from period to period. There can be no assurance that an acquisition will not adversely affect the business relationships of the Company or the acquired entity with their respective suppliers or customers. Further, there can be no assurance that the Company will successfully integrate the acquired operations or achieve any of the intended benefits of an acquisition. The Company's failure to manage its growth effectively could have a material adverse effect on its business and operating results.

*Product Protection and Infringement*

The Company's future success is dependent in part upon its proprietary technology. The Company relies principally on copyright and trade secret law and contractual provisions to protect its intellectual property. There can be no assurance that any copyright owned by the Company will not be invalidated, circumvented or challenged or that the rights granted thereunder will provide competitive advantages to the Company. Further, there can be no assurance that others will not develop technologies that are similar or superior to the Company's technology or that duplicate the Company's technology.

As the Company expands its international operations, effective intellectual property protection may be unavailable or limited in certain foreign countries. There can be no assurance that the steps taken by the Company will prevent misappropriation of its technology. Litigation may be necessary in the future to enforce the Company's intellectual property rights, to protect the Company's trade secrets, to determine the validity and scope of the proprietary rights of others, or to defend against claims of infringement or invalidity. Such litigation or delays in product introductions or decisions to discontinue development, manufacture or sale of such products, could result in substantial costs and diversion of resources and could have a material adverse effect on the Company's business and operating results.

*Reliance on Dealer Network*

A substantial portion of the Company's net sales are made through its network of independent dealers. The Company faces intense competition from other telephone system and voice processing system manufacturers for such dealers' business, as most of the Company's dealers carry products which compete with the Company's products. The Company has no exclusive agreements with any of its dealers. The loss of any significant dealer or group of dealers, or any event or condition adversely affecting the Company's dealer network, could have a material adverse effect on the Company's business and operating results.

*Risks of Providing Long Distance and Network Services*

Inter-Tel depends on a reliable supply of telecommunications services and information from several long distance carriers. Because it does not own transmission facilities, the Company relies on long distance carriers for the provision of network services to the Company's customers and for billing information. Long distance services are subject to extensive and uncertain governmental regulation on both the federal and state level. There can be no assurance that the promulgation of certain regulations will not adversely affect the Company's business and operating results. Contracts with the long distance carriers from which the Company currently resells services typically have a multi-year term in which the Company's prices are relatively fixed and have minimum use requirements. There can be no assurance that the Company will meet minimum use commitments, will be able to negotiate lower rates with carriers in the event of any decrease in end user rates or will be able to extend its contracts with long distance carriers at prices favorable to the Company. The Company's ability to continue to expand its long distance service operations will depend on its ability to continue to secure reliable long distance services from a number of long distance carriers and the willingness of such carriers to continue to make telecommunications services and billing information available to the Company on favorable terms.

*Dependence on Key Personnel*

The Company is dependent on the continued service of, and its ability to attract and retain, qualified technical, marketing, sales and managerial personnel. The competition for such personnel is intense, and the loss of any of such persons, as well as the failure to recruit additional key technical and sales personnel in a timely manner, would have a material adverse effect on the Company's business and operating results. There can be no assurance that the Company will be able to continue to attract and retain the qualified personnel necessary for the development of its business.

*Possible Volatility of Stock Price*

The Company believes that factors such as announcements of developments relating to the Company's business, fluctuations in the Company's operating results, general conditions in the telecommunications industry or the worldwide economy, changes in legislation or regulation affecting the telecommunications industry, an outbreak of hostilities, a shortfall in revenue or earnings from securities analysts' expectations, announcements of technological innovations or new products or enhancements by the Company or its competitors, developments in intellectual property rights and developments in the Company's relationships with its customers and suppliers could cause the price of the Company's common stock to fluctuate, perhaps substantially. Many of such factors are beyond the Company's control. In addition, in recent years the stock market in general, and the market for shares of technology stocks in particular, have experienced extreme price fluctuations, which have often been unrelated to the operating performance of affected companies. There can be no assurance that the market price of the Company's common stock will not experience significant fluctuations in the future, including fluctuations that are unrelated to the Company's performance.

*Potential Fluctuations In Quarterly Results; Limited Backlog*

The Company's quarterly operating results depend upon a variety of factors, including the volume and timing of orders received during the quarter, the mix of products sold, mix of distribution channels, general economic conditions, patterns of capital spending by customers, the timing of new product announcements and releases by the Company and its competitors, pricing pressures and the availability and cost of products and components from the Company's suppliers. The Company's customers typically require immediate shipment and installation of platforms and software. As a result, the Company has historically operated with a relatively small backlog, and sales and operating results in any quarter are principally dependent on orders booked and shipped in that quarter. Moreover, market demand for investment in capital equipment such as digital communication platforms and associated call processing and voice processing software applications is largely dependent on general economic conditions, and can vary significantly as a result of changing conditions in the economy as a whole. The Company's expense levels are based in part on expectations of future sales and, if sales levels do not meet expectations, operating results could be adversely affected. Because sales of digital communication platforms through the Company's dealers produce lower gross margins than sales through the Company's direct sales organization, operating results have varied, and will continue to vary based upon the mix of sales through direct and indirect channels. Although the Company to date has been able to resell the rental streams from leases under its Totalease program profitably and on a substantially current basis, the timing and profitability of lease resales from quarter to quarter could impact operating results, particularly in an environment of fluctuating interest rates. Long distance sales have, in recent periods, grown at a faster rate than the Company's overall net sales and such sales have lower gross margins than the Company's core business. As a result, gross margins could be adversely affected in the event that long distance calling services continue to increase as a percentage of net sales. In addition, the Company is subject to seasonality in its operating results, as net sales for the first and third quarters are frequently less than those experienced in the fourth and second quarters, respectively. As a result of these and other factors, the Company has in the past and could in the future experience fluctuations in sales and operating results on a quarterly basis. See "Management's Discussion and Analysis of Financial Condition and Results of Operations."

*Concentration of Ownership*

As of June 30, 1997, the Company's Chairman of the Board of Directors and Chief Executive Officer beneficially owned approximately 23% of the outstanding shares of the Common Stock. As a result, he has the ability to exercise significant influence over all matters requiring shareholder approval. In addition, the concentration of ownership could have the effect of delaying or preventing a change in control of the Company.

INTER-TEL, INCORPORATED AND SUBSIDIARIES

PART II. OTHER INFORMATION

ITEM I. LEGAL PROCEEDINGS--Not Applicable

ITEM 2. CHANGES IN SECURITIES--Not Applicable

ITEM 3. DEFAULTS ON SENIOR SECURITIES--Not Applicable

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITIES HOLDERS -- Not Applicable

ITEM 5. OTHER INFORMATION -- Not Applicable

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

Exhibits:

Exhibit 11.1 - Computation of Earnings Per Share

Exhibit 27.1 - Financial Data Schedule for June 30, 1997

Reports on Form 8-K -- None

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

INTER-TEL, INCORPORATED

Date 8/14/97 /s/ Steven G. Mihaylo
Steven G. Mihaylo,
Chairman of the Board
and Chief Executive Officer

Date 8/14/97 /s/ Kurt R. Kneip
Kurt R. Kneip,
Vice President
and Chief Financial Officer

EXHIBIT 11.1

## STATEMENT RE: COMPUTATION OF PER SHARE EARNINGS

| (Thousands except per share amounts) | Three Months Ended June 30, 1997 | Three Months Ended June 30, 1996 | Six Months Ended June 30, 1997 | Six Months Ended June 30, 1996 |
|---|---|---|---|---|
| **PRIMARY** | | | | |
| Average shares outstanding | 12,719 | 12,874 | 12,835 | 12,843 |
| Net effect of dilutive stock options--based on the treasury stock method using average market price | 413 | 557 | 404 | 515 |
| **TOTAL** | 13,132 | 13,431 | 13,239 | 13,358 |
| Net Income | $3,424 | $2,784 | $6,094 | $5,683 |
| Per share amount | $.26 | $.21 | $.46 | $.43 |
| **FULLY DILUTED** | | | | |
| Average shares outstanding | 12,719 | 12,874 | 12,835 | 12,843 |
| Net effect of dilutive stock options--based on the treasury stock method using the quarter-end market price, if higher than the average market price | 742 | 609 | 742 | 609 |
| **TOTAL** | 13,461 | 13,483 | 13,577 | 13,452 |
| Net income | $3,424 | $2,784 | $6,094 | $5,683 |
| Per share amount | $.25 | $.21 | $.45 | $.42 |

**INTER-TEL, INCORPORATED AND SUBSIDIARIES**
**FINANCIAL DATA SCHEDULE (EXHIBIT 27.1)**
**THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE INTER-TEL, INCORPORATED AND SUBSIDIARIES FINANCIAL STATEMENTS FOR THE SIX MONTHS ENDED JUNE 30, 1997 AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS**

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Attachment E

NetSolutions' Technical and Managerial Capability

## NetSolutions' Technical and Managerial Capability

NetSolutions will provide telecommunications services throughout the State of Florida except where prohibited by law through the resale of other registered companies' telecommunications services. As a reseller, NetSolutions does not own or control any transmission facilities. NetSolutions proposes to operate as a "switchless reseller" and merely resell telecommunications services of an underlying carrier. Through these services NetSolutions purchases, it will utilize existing equipment and facilities of other authorized carriers to provide services. These services are fully described in Section 3 of the Price List which has been enclosed as Attachment C of this Application. NetSolutions does not have personal knowledge of the specific types of equipment, facilities or routes used by its underlying carriers.

NetSolutions is a company that is uniquely capable of fulfilling all of its customers' telecommunications needs. It has been providing resold long distance service since 1991 and has grown to provide service in 26 states as well as interstate and international service. Because it is owned by Inter-Tel, Incorporated, a well-established and reputable company that has for the last 25 years researched, engineered, produced, distributed, installed and serviced telecommunications products and systems that are among the most technologically advanced in the industry, Inter-Tel NetSolutions, Inc. has at its disposal a considerable wealth of technological expertise and resources.

In addition, as described below, the key personnel in the NetSolutions management team possess the background and experience necessary to ensure success in the resold telecommunications industry:

**STEVEN G. MIHAYLO**, Chairman of the Board, President of Inter-Tel, Incorporated. Founded Inter-Tel Incorporated ("Inter-Tel") in 1969 and has established the company as one of the top three companies in the interconnect industry. Inter-Tel researches, engineers, produces, distributes, installs and services technologically advanced telecommunications equipment.

Steven Mihaylo has a degree in Business with emphasis in Accounting and Finance, in addition to several years with the U.S. Army. Mr. Mihaylo's professional involvement does not stop with Inter-Tel. Aside from his position with Inter-Tel, he is involved with the following organizations:

| | |
|---|---|
| Board of Directors | MicroAge, Inc. |
| Board of Directors | Junior Achievement of Arizona |
| Member | Young Presidents Organization |

**KURT KNEIP**, Chief Financial Officer, Inter-Tel, Inc. and Vice President, Inter-Tel NetSolutions, Inc. since September 1993. Mr. Kneip joined Inter-Tel in May 1992 as director of Corporate Tax, after seven years with the accounting firm of Ernst and Young. Mr. Kneip is a certified public accountant, and holds an undergraduate degree in Commercial Economics from South Dakota State University and a Masters Degree in Professional Accountancy from the University of South Dakota.

**JOHN J. O'BLOCK**, Executive Vice President, Inter-Tel NetSolutions, Inc. since March 1995. Mr. O'Block holds a Bachelor of Science degree in accounting and is a licensed Certified Public Accountant in Ohio. He also holds a Master of Business Administration degree in finance and a Juris Doctor degree. He is a member of the Ohio Bar. Mr. O'Block has over 25 years experience in business having worked for a lift truck manufacturer for 20 years, ultimately becoming the controller of the corporation. In 1988, he became the Vice President/Chief Financial Officer of OMAC, Inc. In 1993, he began working for Mihaylo and Company, a public accounting firm. In 1994, he began a consulting firm, O'Block and Associates.

**MACKEY SELBIG**, Vice President of Customer Service, Inter-Tel NetSolutions, Inc. since May 1994. Ms. Selbig has been with Inter-Tel NetSolutions since February 1992, managing the Customer Service Department. Ms. Selbig attended the University of Albuquerque and has over 25 years of experience in the telecommunications industry, particularly long distance switching and networks with the GTE Operating Company, telecommunications equipment manufacturing with GTE Lenkurt, and five years with Siemens AG long distance division.

# Bickerstaff, Heath, Smiley, Pollan, Kever & McDaniel, L.L.P.

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September 5, 1997

DEPOSIT DATE

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Florida Public Service Commission
Division of Communications
Certification & Compliance Section
2540 Schumard Oak Blvd.
Tallahassee, FL 32399-0850
(904) 413-6600

971196

RE: Application of Inter-Tel NetSolutions, inc. for Authority to Provide Local Exchange Telecommunications Service Within the State of Florida

Dear Filing Clerk:

Enclosed is the original and six copies of Inter-Tel NetSolutions Inc.'s Application for Authority to Provide Local Exchange Telecommunications Service Within the State of Florida.

Also enclosed is a check made payable to the Florida Public Service Commission in the amount of $250.00 to cover the charge of the filing fee.

Please file stamp the extra copy and return to me in the enclosed self-addressed envelope.

130053

BICKERSTAFF, HEATH, SMILEY,
POLLAN, KEVER & McDANIEL, L.L.P.
816 CONGRESS, SUITE 1700
AUSTIN, TEXAS 78701-2443

| CHECK NO. | CHECK DATE | VENDOR NO. |
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| 130053 | 09/05/97 | |

PAY ***Two-Hundred-Fifty Dollars and 00/100***

| CHECK AMOUNT |
|---|
| ***$250.00*** |

TO THE ORDER OF

Florida Public Service Commission
2540 Shumand Oak Blvd.
Tallahassee, FL 32399-0866